

# Welcome to the 'Chinese century'?



## China's transformation

It is perhaps difficult to overstate the sheer immensity of the transformation that is being wrought in China. In merely a few years, entire cities have been summoned into existence and vast industries have been brought into being - as China has emerged from being widely regarded as a peculiar autarchic rural backwater, which was geo-politically significant only for having the bomb and a large army, to being recognised as a major economic powerhouse on the world stage.

Despite repeated predictions in the past that she was heading for a fall, China has sustained a frenzied pace of economic growth - averaging almost 10% a year over the last two decades. Indeed, in the last quarter of a century China's economy has quadrupled in size. What is more, China's economy has not only grown but has had an increasing impact on the world economy. From being almost negligible twenty years ago, China's share of world trade has grown to 13%.

Such sustained rapid economic expansion has led many to see China's continued advance as inevitable. If the last century was the 'American Century', then, it is predicted, China, closely followed by its rapidly growing neighbour India, is leading us into an 'Asian Century'. Certainly if we simply extrapolate from the past this would seem to be the case. Already China is at the point of overtaking the UK to

become the world's fourth largest economy. If her growth rate remains as high relative to the world's major economies, then China can expect to overtake Germany and Japan early in the next decade to become the world's second largest economy. By sometime in the second quarter of this century China would then be expected to be overtaking the USA.

Yet, at this point we should perhaps sound a note of caution. In the face of a bewildering array of statistics about China, which in the past couple of years have abounded in the bourgeois press, we should be wary of being taken in by the latest fads of the investment salesmen. China is where the money is to be made, and, as the dot.com boom showed most clearly, where there is big money to be made there is hype.

Nevertheless the transformation of China and its integration into the global accumulation of capital in recent years raises important issues for understanding the world we find ourselves in and the possible developments in the future. Already, as we shall see, China's transformation has become central to the relocation of manufacturing industry, which was brought about through the restructuring of world capitalism in the 1970s and 1980s. As such, China's economic advance has already had an important impact on the development of capitalism and the class struggle that has emerged within and against it. If China is destined to replace the USA as the world's new hegemon then this would involve an unprecedented political and economic shift of tectonic proportions in the world capitalist system.

Indeed, China's emergence as a major economic power raises crucial questions. What has been the transformation that has occurred in China in recent years? Can China sustain its current rapid economic growth? Can China really become a serious challenger to US hegemony? If so, what implications will this have for world capitalism and the class struggles that may emerge within and against it?

These are certainly wide ranging and formidable questions, and we can only hope to put forward rather tentative answers in this article. In doing so we shall confine ourselves to attempt to bring out the immediately apparent objective tendencies of the current historical dynamic of China's economic transformation and its integration into global capital accumulation. Class struggle will only be taken in its result, as we develop our analysis in the reified terms of geo-politics and global political economy that immediately confront us. Of course, this, as we readily admit will be one-sided - we shall be considering merely the logic of capital itself. However, we see this article as a first step in addressing an issue that still remains *terra incognita*. In the next issue we hope to go beyond this to consider how the transformation of China is bringing about class re-composition and new class struggles.

This article comprises of two parts. In Part I we shall briefly consider China's economic transformation of recent decades. In Part II we shall see how this transformation has led to China's integration into the global accumulation of capital and the implications this has for both China and the world.

## Part I: China from Mao to now

### Introduction

The dominant view of China's transformation, and one that underpins much of what passes for analysis in the bourgeois press, is that of what may be termed fabian neo-liberalism. According to this view China, since the beginnings of liberal economic reforms in 1978, has been in the process of making the transition to a 'free market economy'.

Under Mao, we are told, China was a predominantly peasant economy that was mired in poverty and economic stagnation. China, like the USSR at the time, had been held back for decades by a naturally bureaucratic and inefficient state-run command economy. However, with Mao's death an enlightened faction of the Communist Party leadership around Deng Xiaoping saw the error of their ways. They discarded the politically correct boiler-suited austerity of Maoism and began the long and difficult process of overcoming vested special interests to bring about liberal economic reforms. Looking to Adam Smith, rather than Marx, Deng called on the Chinese people to enrich China by enriching themselves and expanded the role of the market at the expense of the state.

It is then concluded that the natural economic superiority of the market combined with the inherent entrepreneurial inclinations of the Chinese people, which for so long had laid dormant under Mao, has led to the rapid economic growth and prosperity that we witness today. For our fabian neo-liberals China is the model of a successful 'emerging market economy', which provides a lesson for all those nations seeking to make the transition from a command economy to a 'free market economy'.

However, in the 1970s, Mao's China had been held up as a model for 'third world' developing economies seeking to modernise and industrialise. For Western development economists and theorists, including many that were not necessarily on the left, China's socialist model had succeeded not only in achieving high rates of industrialisation but had combined this with a high degree of equality of wealth and income, as well as meeting the basic needs of the vast majority of its population.

Indeed, for the socialist opponents of our fabian neo-liberals, the liberal economic reforms introduced since Mao's death may have enriched tens of millions of Chinese, and in doing so created an affluent Western-style middle class, but it has only done so by plunging hundreds of millions into economic insecurity and exploitation. As such, for these socialists, the 'transition to a free market economy' is merely a euphemism for the restoration of capitalism. As they correctly point out, the economic reforms of the last two decades have led to a particularly ruthless Dickensian capitalism. Hundreds of millions of Chinese have lost access to even the rudimentary health care offered under Mao. Tens of millions are unemployed and the number of beggars and people living on the street has grown enormously. Others have been forced to work sixteen hours a day with only one day off a month in factories where health and safety regulations are regularly flouted.<sup>1</sup>

<sup>1</sup> See Robert Weil, *Red Cat, White Cat: China and the Contradictions of Market Socialism* (Monthly Review Press, 1996) and Martin Hart-Landsberg and Paul Burkett, *China and Socialism: Market Reforms and Class Struggle* (Monthly Review Press, 2005).

However, while the socialists do well to expose the realities behind the so-called 'transition to a free market economy' it remains a moral critique. In accepting the exploitation of the working class and peasantry under Mao as necessary to develop the forces of production they can then not deny that Deng's 'restoration of capitalism' has also led to the rapid development of the productive forces.

We shall now sketch out the economic development of China that has brought about its recent transformation. In doing so we define three distinct phases, which we see as phases in China's transition to a fully fledged capitalism. The first phase is that of China's state capitalist development,<sup>2</sup> which occurred under Mao. The second phase is that of the liberal economic reforms introduced under Deng in the 1980s, which as we shall see ran into an impasse that was brought to a head by the events in Tiananmen Square in 1989. These two stages provided the political and economic pre-conditions for the third phase, which as we shall argue is the key to understanding its current transformation, which is China's integration into the global accumulation of capital.

### China under Mao<sup>3</sup>

The declaration of the People's Republic of China (PRC) on October 1949 crowned a remarkable achievement by the Chinese Communist Party (CCP). Having been formed only twenty eight years before by a few dozen intellectuals inspired by the Russian Revolution, the CCP had brought to completion, what they themselves recognised, as the Chinese national bourgeois revolution. After three decades of warlordism, civil war and Japanese occupation, China had been more or less reunited. Furthermore, with the expropriation of foreign capitalists, landlords and their allies, who had for so long held back the development of capitalism in China, the way was open, it seemed, for the national accumulation of capital.

But any hopes that the CCP might be able to preside over a 'mixed economy' and the gradual development of Chinese capitalism - which was the most the CCP had hoped for in the economically backward conditions they found themselves in - was soon shattered by the outbreak of the Korean War. Within less than a year of the proclamation of the PRC American troops were within striking distance of the Chinese border. The People's Liberation Army, despite often facing overwhelming enemy firepower, succeeded in forcing the American forces back, but at the cost of more than a million casualties.

Although the Korean War was considered a heroic victory, it was a victory that seemed only to buy time. Sooner or later, it was feared, there would be a US-backed invasion from the nationalist stronghold of Taiwan. As a result, it soon became clear to the leadership of the CCP that if they

<sup>2</sup> The question of whether China was state capitalist under Mao is beyond the scope of this article. We recognise that our theory of state capitalism (see 'What was the USSR?', *Aufheben* # 6-9) is perhaps too abstract to take account of the peculiarities of China and requires further development. We hope to address this question in more detail in the future article which will consider the transformation of the class and production relations in China since Mao.

<sup>3</sup> For a more detailed account of the Maoist period see, Maurice Meisner, *Mao's China: A History of the People's Republic* (Free Press 1977). For a history of the reform period see, Gordon White, *Riding the Tiger: The Politics of Economic Reform in Post-Mao China* (Macmillan, 1993).

were to defend the hard won gains of the national revolution from American imperialism then it would be necessary to build modern well-equipped armed forces. Yet modern armed forces needed tanks, artillery, battleships and high explosives and, to build these on the scale that was necessary to ward off attack, China required heavy industry. It was therefore clear to the leadership of the CCP that China had to industrialise, and it had to industrialise fast.

As a result, in 1952 China moved decisively towards a command economy and state capitalism. A programme of nationalisation was launched - which within four years was to bring almost all trade, commerce and industry into public ownership - and the first five-year economic plan was drawn up designed to galvanise what was still a predominately peasant economy for the colossal task of rapid industrialisation.

As now the sole employer, the Chinese state assumed the direction of labour, determining who worked where and when, through its various employment bureaux. It also imposed a national eight-grade wage scale. At the same time, the government raised taxes on the peasantry, which were often collected in kind, and, exploiting its position as sole purchaser, paid low prices for the main staple agricultural produce. As a result, the incomes of workers, peasants and indeed the cadre of lower echelons of the Party-State were screwed down to a minimum.

However, although wages, salaries and incomes were pressed down to a minimum, the state ensured through the *danwei* system and the policy of the 'iron rice bowl' that they were secure, and provided a basic system of welfare for the mass of the working population - a great boon for many Chinese at that time who had only known years of war and uncertainty.<sup>4</sup> As a consequence, the state was able to maintain social peace as well maximising the surplus product appropriated from the workers and peasants. The surplus product, through the economic plan, was then being concentrated into the construction of heavy industry and military production. Through most of the period under Mao more than 30% of national output was devoted to investment, and in the peak year of 1957 this rose to almost 50%.

With Russian aid and technical assistance, the first five-year plan proved to be a remarkable success, with many of the highly ambitious targets being met well ahead of schedule. However, by the mid-1950s it was becoming clear that plans to maintain rapid industrialisation would soon run into the limits imposed by the low productivity of traditional Chinese agriculture. The land reforms, which had followed the expropriation of the landlords, had left land in the hands of a mass of individual peasant households, many of whom were barely able to produce much more than their own subsistence let alone provide food for an expanding industrial workforce.

<sup>4</sup> The *danwei* system has been the form of social organisation that characterised China's urban workplaces. Translated into English as 'work unit', its function, however, was far broader than this term suggests. At a basic level its role was to administer the 'iron rice bowl' of welfare and social guarantees to the working class in the form of subsidised housing, cheap food and medicine, health care and pensions to name but a few. In addition it carried out essential monitoring and regulating functions. As such the *danwei* played an important role in integrating the working class within the Party-State.

The solution proposed to deal with this problem was the collectivisation of agriculture. The amalgamation of the small plots of the individual peasant households into larger units, it was argued, would facilitate the introduction of modern farming methods, the more rational use of labour and above all the mechanisation of agriculture. It was also seen as a means of forestalling the emergence of a distinct class of rich 'Kulak' peasants that could undermine the CCP's political control of the peasantry and its ability to wage political campaigns exhorting the peasantry to increase production.

At first, the state planners had envisaged a gradual programme of collectivisation that would take perhaps almost a generation to complete. For them the overriding imperative was the construction of heavy industry and there were very few resources to spare for the construction of tractor plants and other industries producing agricultural inputs. In spite of this, under the slogan 'collectivisation before mechanisation', Mao pressed for a rapid acceleration of the programme of collectivisation leading to what was to become the disastrous 'great leap forward'.

However, although the more grandiose schemes for uniting agriculture and industry in huge rural communes were abandoned, the essential features of what was to become identified as the particularly Maoist model of development remained in place. Under the authority of the rural communes the under-used labour of the peasants during the slack times of the agricultural calendar was mobilised for major projects of land reclamation, irrigation works and road building; as well as for the establishment and running of rural industries producing inputs for agriculture, such as fertiliser plants, tractor repair units and so forth.

By using highly labour intensive techniques, particularly for the major construction and reclamation projects, such rural development made minimal demands on the industrial sector of the economy for inputs and instruments of production. Rural economic development could run side by side with rapid industrialisation or, as Mao put it, China could 'walk on two legs'.

As a result, at the time of Mao's death in 1976, China was far from being 'mired in economic stagnation'. If the years of political and economic disruptions of the Great Leap Forward (1958-61) and the Cultural Revolution (1966-9) are excluded, industrial production grew at over 10% a year under Mao, turning China into the sixth biggest industrial producer in the world. Not only this but, although it expanded far slower than industry, agricultural production was still able to keep ahead of the growth in China's population.

Thus, it may be said, by maintaining national integrity against the threat of imperialist intervention, and through a high rate of exploitation of the workers and peasants, Mao's autarchic command economy was to provide the basis for the subsequent phases in China's transition towards capitalism.

### The First Wave of Reforms

Although China was neither mired in stagnation like the USSR, or facing an acute economic crisis at the time of Mao's death, there were certainly dark clouds on the horizon.<sup>5</sup>

<sup>5</sup> The question of how far the liberal economic reforms introduced in the late 1970s were a result of clear plan on the part of Deng

Firstly, though there had been improvements in health and welfare provision, the personal incomes of the mass of the working population had barely risen since the 1950s.<sup>6</sup> It was not clear to many in the leadership of the CCP how far such a state of affairs could continue. Secondly, with the abandonment of the unpopular policy of sending youth to be 'educated by the peasants' in the countryside, there was a growing problem of urban unemployment, particularly among the educated sons and daughters of party cadres.

Of course, within the command economy the state could have simply raised incomes of workers and state-officials by upwardly revising the national wage scales. Likewise, for the peasantry, it could have cut agricultural taxes and raised prices on agricultural produce. At the same time, the state could have made work for the unemployed.

However, all three measures would have increased the necessary labour required to reproduce the working population and thereby would have squeezed the amount of surplus labour the state could appropriate for accumulation. Not only this, increased personal incomes, once spent, would have led to a rise in the demand for consumer goods. This would have meant that a larger proportion of the diminished surplus labour that was appropriated would have to be invested in the expansion of consumer-oriented industries at the expense of heavy industry and military production. Yet, by the late 1970s, much of the heavy industry constructed in the 1950s was reaching the end of its useful life, and in the coming decade or so would have to be replaced or modernised. There was therefore a contrary economic imperative to increase the amount of surplus product devoted to investment in heavy industry.

The obvious resolution of this problem was to raise the productivity of labour, but the autarchic command economy, which had grown up under Mao, imposed formidable barriers for such a solution. Firstly, China's isolation, particularly following its break with the USSR in 1960, had meant that much of Chinese industry remained technologically backward. Capital accumulation had been largely extensive, that is it was expanded by simply building more factories and plants employing more or less the same technology that had been inherited from the 1950s. As a result the growth in labour productivity remained sluggish.

The political and collective integration of the large sections of the industrial working class into the Party-State through the mediation of the *danwei* system was perhaps an important reason why China had been able to avoid the phenomena of endemic waste that in the USSR had led to falling labour productivity. However, the *danwei* system did serve to prevent attempts to introduce new working practices that would have intensified labour and raised the rate of exploitation. Moreover, the *danwei* system gave the workers a certain collective power of veto over the running of their factories. At the same time, factory managers and party secretaries in the workplace owed as much allegiance to 'their' *danwei* as they did to the imperatives of increased production emanating from higher levels of the Party-State. Even if they were inclined to take on their workforce, with life-long employment guarantees and nationally set wage

rates, factory managers had neither the carrots nor the sticks to overcome resistance to any intensification of labour.

As far as industry and urban areas were concerned, the problems facing the leadership of the CCP, of potential unrest arising from low wages and urban unemployment, and the need to replace obsolete industrial capacity and the sluggish growth in the productivity of industrial labour, were all of medium to long term nature. Far more imminent were the problems that were arising in agriculture, and indeed it was the attempts to address such problems that were to trigger the subsequent avalanche of liberal economic reforms of the 1980s.

In the 1950s, the role of the CCP and the PLA as both protectors from the predations of landlords and the Japanese occupying forces and champions of the poor and oppressed members of the village communities, was still fresh in the memory of China's peasantry. At that time the campaign for collectivisation had served to revitalise the support of an increasingly urban centred CCP within rural areas. However, by the 1970s such memories would have faded. For the peasant, the CCP appeared in the figure of the Party boss of the commune demanding backbreaking work on local construction projects or else in the guise of the tax collector or grain procurement officer. With such divisions between the peasantry and the Party-State, rural collectives would have only served to strengthen the bargaining position of the peasants. By the mid-1970s, the state was finding it increasingly difficult to appropriate a surplus product from the peasantry. Indeed, the amount of grain procured from the peasantry had stagnated and had even begun to decline.

Following experiments in various areas around the country, in 1980 it was announced that fundamental economic reforms of agriculture were to be rolled out on a national scale. Firstly, agricultural collectives were to be broken up and the state would draw up contracts for the purchase of staple crops with each individual peasant household. Secondly, the peasant household would be free to sell anything they produced beyond the production quotas agreed in their contracts in local markets. Thirdly, the communes were to be stripped of many of their functions, including their powers to mobilise corvée labour, and be renamed township or village authorities. In addition, in order to give an incentive to increase production, procurement prices for agricultural products were raised by 20%.

On the basis of the land reclamation, more efficient irrigation and improved road and communication, which had been brought about by past corvée labour which had been mobilised by the communes and from which they were now freed, together with the incentives provided by the rise in procurement prices, peasants were able to concentrate on expanding agricultural production. As a result, there was a substantial spurt in the growth of agricultural output. This immediate success of agricultural reforms served to build political momentum for the much more far-reaching reforms that were introduced in the early 1980s.

There were three main planks in what we term the first wave of liberal economic reforms, which occurred in this period. Firstly, several maritime provinces and cities in the south of China were designated as 'Special Enterprise Zones' (SEZ). Within these zones the prohibitions on small to medium sized private businesses were lifted and the regulations on foreign trade and commerce were lifted. Secondly, the central plan was pruned back. The number of products subject to central planning quotas and prices was

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Xiaoping or the unintended outcome of intra-party struggles is outside the scope of this article.

<sup>6</sup> In 1978 it was estimated that 150 million Chinese peasants still suffered from periodic hunger.

reduced. At the same time, those large-scale enterprises that remained subject to production quotas and prices were permitted to sell anything they produced beyond their quotas at 'market prices'. Thirdly, and most importantly, there was a fundamental re-organisation of state finance and planning.

With the industrial-bureaucratic structure that had grown up as a result of the imperative of the rapid development of heavy industry, what were considered the core industries were placed under the direct control of the central state apparatus. The central planning agencies set output quotas for each of the firms in these core industries and the price at which this output was to be sold. The appointment of managers, and the overall direction of each firm were then overseen by the relevant ministry or state commission responsible for the industry as a whole.

However, the responsibility for those firms that were not considered to be part of the core of the economy - that is small and medium sized firms involved in the production of intermediate and consumer goods - was delegated to lower levels of the Party-State structure. Each of these firms was ranked in order of size and economic or political importance and the planning and direction assigned to local state bodies of the corresponding administrative level. In towns and cities these firms were known as urban collectives or co-operatives, while those in rural areas were to become known as Township and Village Enterprises (TVE).

In the old system of state finance - known as 'eating out of one pot' - money simply followed the plan. Money was 'ladled out of one central pot' to the various state commissions and state ministries in charge of the core industries, and also to the provincial governments. The state commissions and state ministries, after keeping enough to pay their own administrative expenses, passed on the money to the central state industries under their charge to cover the costs of production and investment necessary for them to meet their part of planned production. Likewise, the provincial governments passed on funds to firms under their charge in accordance with their own provincial plans. But they also passed money down to subordinate levels of the administration in accordance with agreed local economic plans and so on. This downflow of funds was counter-balanced by an upward flow of revenues as the money receipts of each firm or state body had to return back up to the one central pot.

In this way, money acted as little more than a measure of value and a means of circulation. The flow of finance was no more than a supplementary control in a relatively decentralised planning system aimed at the expansion of productive capital. The state banks existed mainly to provide credit to smooth out the different timings of payments and receipts for firms and the various state administrative organs.

The reformed system replaced the principle of 'eating from one pot' with what became known as 'eating from separate kitchens'. Local administrative state bodies and their associated firms were now to keep their revenues to pay their costs. If there was any money left over after paying costs, an agreed sum would be paid to the central state coffers, while any amount of profit above this could be used at the discretion of local state officials and factory managers. It was then expected that the agreed sum payable to the central state would be gradually revised upwards with subsequent agreements. Thus it was hoped that local state

officials and factory managers would have both the incentive and pressure to increase the profits and production of local enterprises.

For the leadership of the CCP, the reformed system promised to encourage the efficient expansion of consumer orientated industry, providing more consumer goods and increasing employment, while at the same time defusing pressure from lower party cadre for increased incomes by allowing them to make some money on the side. For the central planners, the new system introduced a looser and more fungible monetary relation with lower state bodies. They were relieved of the onerous task of overseeing detailed local plans and instead only had to carry out regular profit sharing negotiations. They were thereby able to concentrate on planning the core of the economy.

However, the profit sharing agreements proved far too generous, leading to a feverish pursuit of profit on the part of local state officials and factory managers. This was particularly the case in the SEZs. The lifting of prohibitions on trade and commerce in the SEZs had prompted a repatriation of small sums of capital from the Chinese business diaspora in Taiwan, Hong Kong and other parts of East Asia leading to a rapid growth in private, small scale trade and industry. The demand emerging from the growth in the private sector, combined with ready supplies of inputs from the central state sector and labour from peasants who had lost out from the agricultural reforms, gave local state officials and factory managers both the means and the opportunity to use their retained profits to expand production. As a result, there was an explosive growth in the production of urban collectives and TVEs, leading to an economic boom that rapidly began to get out of control.

The generous profit and revenue sharing agreements resulted in a huge hole in the central state's budget. Mounting state budget deficits, combined with the easy credit being supplied by an unreformed banking sector, led to accelerating price inflation and a small but growing foreign trade deficit. The immediate response of the state to this growing inflationary crisis was to attempt to balance the budget by cutting back on investment in the central state sector of the economy. This not only saved the state money and helped reduce its budget deficit, but it also meant that the planned production quotas of the central state industries could be reduced, allowing them to sell more of their output on the market, thereby reducing the market price of heavy industrial commodities sold to the non-central state sectors.

Yet, such emergency cut backs only served to buy time. Rather than back tracking on reforms, the reformers within the leadership of the CCP were able to insist on using the crisis to press on with further liberal reforms in order to correct the economic imbalances.

Firstly attempts were made to reform the organisation of central state enterprises to make them more profit-orientated businesses. The powers of factory managers and directors over the running of their firms were increased. The political interference of party secretaries in the running of the firms was curtailed and the discretionary powers over production and investment enhanced by the introduction of profit sharing agreements. In certain selected central state enterprises managers were able to break from the national wages scales so that they could introduce performance related pay and life-long employment guarantees were replaced, at least formally, by time-limited employment contracts.

Secondly, attempts were made to wrestle back control of state funds by replacing the process of negotiating revenue and profit sharing with each particular local state body with a standard universal tax system, which would be levied not as a fixed sum but as a proportion of profits. Finally, the banking system was re-organised on a more centralised basis.

For the most part these reforms either failed or were derailed. Many central state factory managers used their new discretion over company funds and wage rates to appease their work force by using retained profits to fund across the board pay increases to compensate their workers for rising price inflation. Those who did not, found themselves facing a wave of industrial disputes. The introduction of a universal tax system was effectively negated by concessions made to provide grants to those local state bodies that might lose out with the new system. While the banking reforms proved ineffective in reining back the expansion of easy credit.

Meanwhile growing problems in agriculture threatened to produce a serious political and economic crisis. By the mid-1980s the spurt of agricultural production, which had followed the introduction of economic reforms, had begun to peter out. The reforms had given peasants the incentive to increase production, not only by increasing procurement prices, but also by allowing them to sell anything they produced above that contracted to the state at higher market prices. However, while peasants increased production for the market, market prices had fallen.

Furthermore, although the reforms had given peasants the incentive to increase production, they had done little to increase the productive capacity of China's agriculture. Indeed, if anything they had impaired it. Firstly, with the drive to expand rural industries, the township and village authorities had done little to maintain the roads and irrigation projects that had been constructed in the pre-reform period, which in many areas were vital to sustaining the productivity of agriculture. Secondly, the break up of the collectives meant that the advantages of mechanisation and modern farming methods dependent on large-scale collective farming were lost.

Attempts to raise procurement prices to stimulate greater agricultural production only served to exacerbate the problems caused by inflation in the urban areas. Either the state had to subsidise food, in which case the state deficit would be plunged deeper into deficit, or else food prices would have to rise, thereby fuelling the growing unrest amongst the urban working class already being squeezed by the rising price of necessities.

Already by the end of the 1980s the mounting economic and political problems had led to a slowing in the momentum for liberal reform and indeed, in some circumstances, had required a reversion to more direct methods of economic control. Following the events at Tiananmen Square in June 1989, Zhao Ziyang - who had been the chief proponent of reforms - was removed from office and the reform process was brought to an abrupt halt.

#### *In the wake of Tiananmen*

In the early 1990s, the liberal reforms of the 1980s seemed to have reached an insurmountable *impasse*. Indeed, from the perspective of many of the old guard within the CCP leadership they would have probably been seen as a disastrous failure. Certainly it was true that the reforms, particularly in their early stages, had increased incomes of

millions of peasants and many workers; while quite a few state officials had made a fortune. The growth of urban collectives and co-operatives as well as TVEs had helped to correct the imbalance between heavy and light industry.

However, after a ten-year dearth of investment, heavy industry within the state sector was now in a far more dilapidated condition. What is more, the reforms had ended up in creating the very social and political strife that they had intended to forestall.

Ten years before, many Western observers had applauded the early success of Chinese reforms, and argued they showed how easy it was for a command economy to make the transition to a 'free market economy'. Now, in the early 1990s, for many Western observers, the Chinese experience, following as it did the fate of similar reforms in Eastern Europe, seemed only to confirm the view that attempts to make a gradual transition to a 'free market economy' via a stage of 'market socialism' inevitably ended in failure. Indeed, for those seeking to persuade Yeltsin to open up Russia to a free market free for all, China's failed reforms underlined the case that there was no option but a big bang approach to such a transition to a 'free market economy'.

How was it, then, that the reforms of the 1980s, which had succeeded so well at first, ended up in such an *impasse*?

As several academic studies have argued, one of the crucial factors in the early success of the reforms had been the decentralised structure of the Chinese Party-State when compared with other state capitalist systems. As they argue, this facilitated the transformation of local state officials into what we may term 'entrepreneurial bureaucrats' or perhaps better still 'red capitalists'. Indeed, many urban collectives and co-operatives, and in fact many TVEs, became effectively private businesses under the *de facto* private ownership of their profit-driven state managers. At the same time, many of the newly emergent private capitalists, in a practice known as 'red capping', obtained public status for their businesses in order to gain regulatory privileges. Indeed, the distinction between public and private ownership became increasingly blurred.

Furthermore, although a few were descendants of old capitalist families, the majority of the new private capitalists that emerged in the SEZs, were ex-Party-State officials, who were able to set up in business due to their access to public funds and connections with the Party-State bureaucracy. Indeed, crucial to the success or failure of any business venture were the connections the businessman could establish with the appropriate ranking Party-State officials in the locality, who were responsible for overseeing and regulating his size and type of business. Such connections not only provided the businessman with protection from adverse shifts in policy but also, in an economy still dominated by the state, access to important business opportunities and advantages.

In the absence of a well-defined commercial law and an 'impartial' legal system that could enforce contracts, and with business regulations largely dependent on the discretion of local Party-State officials, the mutual trust necessary for business dealings was built up around the traditional system of inter-personal connections known as *quanxi*. *Quanxi* bound individuals together in social networks based on mutual respect, obligation and honour, which was affirmed through the strict observance of

ritualised etiquette. By confining business dealings with members of their own *quanxi* networks, businessmen, whether public or private, could be reasonably sure that contracts would be honoured and any irregularities not reported to the police or other authorities.

As a result, the capitalist class, which emerged with the economic reforms of the 1980s, was enclosed within the matrix of the Party-State and was bound to the state bureaucracy through close business and *quanxi* connections. This new emergent class, therefore, had strong vested interests in defending the political *status quo* of the authoritarian one-party state.

From this, liberal academic observers concluded that the economic reforms of the 1980s, far from leading towards a Western-style 'free market' society, had ended up creating a hybrid system, which ultimately was a dead end<sup>7</sup>. For them, sooner or later liberal economic reform had to be accompanied by political reform. The 'free market economy' presupposed 'the rule of law' and protection from arbitrary government, unambiguous rights to private property, and a pluralistic political system which would give bourgeois individuals and corporations equal access in influencing government policy - subject only to the depths of their pocket of course. But China's newly emergent red bourgeoisie, which had emerged from the 1980's reforms, blocked any move towards political reforms necessary for the establishment of liberal democracy. Without political reform, these liberal academics insisted, there could be no more movement towards a 'free market economy'; and without a 'free market economy' there could be little or no further economic progress.

However, as we shall see, both the continued dominance of the one-party state, and the cohesiveness and exclusivity of China's red bourgeoisie were to play a central role in the economic transformation that has taken place since the early 1990s.

### The Second Wave of Reforms

With hindsight, the events of Tiananmen Square, coming as it did in the midst of the disintegration of the Eastern Bloc, provided the shock that allowed the leadership of the CCP to reassert central control over the Party-State structure, which had been loosened by the first wave of reforms. The fear that the Party-State might go the same way as those in Eastern Europe and the USSR could be used to persuade lower ranking bureaucrats to subordinate their particular interests to the interests of the regime as a whole. The leadership of the CCP was thereby able to wrestle back control over the distribution of the state budget and re-establish financial and economic stability.

Following a tour of the SEZs in Southern China in the summer of 1992, Deng Xiaoping felt confident enough to announce a renewed effort of reforms. However, while at

first the main element of the new wave of reforms was simply extending SEZs to more cities and provinces, the new wave of reforms were to take a distinctly new direction that was made possible by events occurring outside of China.

As a result of the sharp appreciation of the yen against the US dollar following the Plaza Accord of 1985, Japanese exports began to relocate their more labour intensive production processes to those neighbouring countries in East Asian economies which had plentiful supplies of cheap and compliant labour power and whose currencies were pegged to the US dollar. At first Japanese capital flooded into Taiwan and South Korea, but then, as wages began to rise, investment began to flood into what were to be come known as the East Asian Tigers.<sup>8</sup> This led to the East Asian boom, which was further fuelled by American and European capital seeking investments that would enable them to outflank their own entrenched working class.

By the early 1990s foreign capital had begun eyeing up the vast potential profits that could be made if it could gain access to the cheap and compliant labour power of China. Indeed, China did not merely have a vast pool of cheap and compliant labour-power, often already schooled in wage-labour, but, as a result of capital accumulation both in the Maoist period and through the first wave of reforms, it had the advantage over other East Asian economies of having a relatively developed and broad industrial base that could provide vital local inputs and services. China also had a relatively developed social and economic infrastructure to support industrial production.

However, given China's enclosed and exclusive business world closely tied to Party-State structures, foreign capital had little option, if was to gain access to the huge profit potential offered by China's vast reserves of cheap and compliant labour-power, but to do deals with the Chinese state. Indeed, the Chinese state found itself in a strong bargaining position, even with the major transnational corporations, and was quite prepared to dictate terms.

For the most part, foreign capital was only permitted access into China if it took the form of direct investment in real productive capital: that is in the concrete forms of plant, machinery and factories. For large-scale investments this has usually taken the organisational form of joint ventures between a state-owned corporation and a transnational corporation, in which the state usually retains a controlling interest. In such joint ventures the transnational is expected to provide the advanced technology embodied in modern plant and machinery, and the technical know-how and management skills to use it. The transnational corporation is also usually expected to provide the marketing and sales and distribution networks necessary to sell the commodities produced in world markets. In return the Chinese state provides the social and economic infrastructure - that is workers' dormitories, roads and communication networks etc. - and of course cheap and compliant labour-power that is often shipped in via the state's employment bureaux from the China's interior. The profits on these joint ventures are then shared between the state and the transnational corporation.

Up until 1992 most foreign investment in China had been small to medium scale investments originating from Hong Kong, Taiwan and to a lesser extent Japan. However, with the new accommodating attitude following Deng's

<sup>7</sup> See Susan L. Shirk, *The Political Logic of Economic Reform in China* (University of California Press, 1993). For a case study of the social origins of China's emerging capitalist class and its close connections with the local state officials in the 1980s and early 1990s see David L. Wank, *Commodifying Communism: Business, Trust, and Politics in a Chinese City* (Cambridge University Press, 1999). For a more recent study concerning the continuing connections of China's capitalists to the party-state see, Bruce J. Dickson, *Red Capitalists in China: The Party, Private Entrepreneurs and Prospects for Political Change* (CUP, 2003).

<sup>8</sup> Indonesia, Malaysia, Philippines and Thailand.

Southern tour, large-scale investments started flooding in from much further a field. As a result, direct foreign investment soared from little more than US\$1 billion in 1992 to more than US\$50 billion a year in 1994. This tidal wave of foreign direct investment saw the rapid growth of export-orientated manufacturing industry, which has become the driving industrial sector of capital accumulation in China since the early 1990s.

However, this flood of foreign direct investment also had more immediate beneficial effects for the Chinese state. Firstly, as the profits from joint ventures began to stream into the state's coffers, the state has been able to fill the hole in its budget deficits. Secondly, as exports increased, as a result of this foreign direct investment, China's foreign trade deficit turned into a trade surplus. This surplus has provided the state with foreign currency reserves, which could be used to buy up food on the world market when necessary due to bad harvests in China. Thirdly, by creating employment, and by spreading business practices to the higher echelons of the state bureaucracy, joint ventures were to create more favourable conditions for the restructuring of the increasingly dilapidated industries still owned and run by the central state.

#### *Restructuring of the central state industries*

As we have seen, the first wave of reforms in the 1980s had focused on small and medium scale industry and agriculture. As urban collectives, TVEs and private trade and industry expanded, the large heavy-scale industry inherited from the Maoist period had been starved of investments and had been allowed to decline. Now, with the second wave of reforms, attention turned to this neglected central state sector.

In the mid-1990s the system of direct state planning through imposition of production quotas and official state pricing was phased out and the moves towards giving factory managers more autonomy of finances, which had been tentatively introduced in the 1980s, were extended across the central state sector. Then, at the 15th Party Congress in 1997, a wholesale restructuring of the central state sector was announced, which aimed to transform what were now to be known as state-owned enterprises (SOEs) into exclusively profit-orientated corporations.

The first step in the programme of restructuring was the privatisation of the smaller SOEs, mainly in the form of management or worker buyouts. The next step was to transform the remaining SOEs into more Western-style joint-stock companies. However, although some shares were sold to private investors on China's newly established stock market, the vast majority of shares were 'non-tradable' and were usually held by various state bodies. As a result, the Chinese state has in effect been transformed into a vast holding company owning the majority of shares in most large-scale enterprises.

Through the separation of ownership and management along the lines of Western corporations, these organisational reforms have made it far easier to establish joint ventures with foreign capital. However, they have also paved the way for the third step of the process of corporatisation, which involves transforming SOEs into exclusively profit-orientated organisations. Central to this transformation has been the transfer of the social functions of the SOEs to state authorities, which has meant the dismantling of the *danwei* system and with this a direct attack on the entrenched position of a large part of the

Chinese working class. This third step of the restructuring of the SOEs has been the most difficult and long drawn out, as we shall see in more detail in Part 2.

#### *Trade liberalisation and entry into the WTO*

As this ambitious plan for the restructuring of the central state sector was being announced, China was being hit by the economic typhoon that had been sweeping across East Asia.

As we have seen, China had been drawn into the East Asian economic boom that had come about through the relocation of capital accumulation from the advanced capitalist economies. In the early 1990s, under pressure from the US government, the East Asian Tigers had relaxed their capital controls to allow the influx of loanable capital. As Western banks and investment funds saw the huge returns that could be made in the 'miracle economies' of East Asia they rushed to lend money-capital to East Asian banks and companies and to buy shares in East Asian ventures. At first this flood of foreign moneyed-capital served to accelerate the accumulation of real capital in the East Asian Tigers.

However, as growing labour shortages and other bottlenecks began to slow down the rate of real accumulation, such investments became increasingly speculative. Then in 1997 it started to become clear that the prospective profits upon which these speculative investments had been made might not materialise. Foreign moneyed-capital rushed for the exits. As they rushed to turn their investment capital back into US dollars the national currencies of the East Asian Tigers could no longer sustain their peg to the US dollar and collapsed one by one. Having borrowed in US dollars and with profits and returns in their own currencies, many banks and companies in the afflicted East Asian economies were now in no position to meet their debt obligations and either went bankrupt or were nationalised. As a result, in little more than eighteen months tens of millions of East Asian workers were made redundant and plunged into absolute destitution.

The panic that arose out of the East Asian crisis rapidly spread across the world, as global finance capital took fright at investments in what was called the 'newly emerging market economies', causing serious financial crises in South America and in Russia. However, although she had close connections to capital accumulation in the East Asian Tigers, China was able to ride out the economic storm without too much trouble. The main reason for this was that the state continued its control of the economy. Because the Chinese state had been able to insist that foreign capital be tied down to investments in real productive capital based in China, and because the Chinese authorities insisted on maintaining tight controls on the movement of capital in and out of the country, foreign capitalists were in no position to liquidate their investments and head for the doors when financial panic struck. The Chinese state was therefore able to contain the financial panic resulting from the East Asian crisis, and prevent an economic meltdown.

Having burnt their fingers with investments in the 'newly emerging market economies', international investors now turned their attention to the dot.com boom in the USA. As a result, foreign investment into China did begin to decline in the immediate aftermath of the East Asian crisis. This threatened to bring to a halt China's strategy of export-led capital accumulation. In response to this the leadership of the CCP decided to take the irrevocable step in its integration

into the global accumulation of capital by joining the WTO, even if meant accepting rather onerous terms of admission.

After protracted negotiations China joined the WTO at the end of 2001. In a five-year transition period China has been required to open up its economy, at least formally, to foreign competition. As a result, tariffs on imported commodities have been cut from an average of more than 40% to a mere 6%, the lowest of any major 'developing' economy in the world, while export subsidies have also been abolished. However, while such economic liberalisation has caused problems, particularly for China's backward agriculture, membership of the WTO has served to limit protectionist moves, particularly on the part of the USA, against China's exports.

Furthermore, membership has done much to reassure foreign investors that the CCP was irrevocably committed to its integration into the global accumulation of capital. Indeed, following the dot.com crash foreign capital has poured into China fuelling its export-led growth. In fact, China in 2004 became the world's largest recipient of foreign direct investment.

In Part 2 we will consider in more detail China's integration into the global accumulation of capital and what implications this may have for the future. Now we shall make a few brief remarks summing up our sketch of China's economic transformation.

#### *What is China and where is it going?*

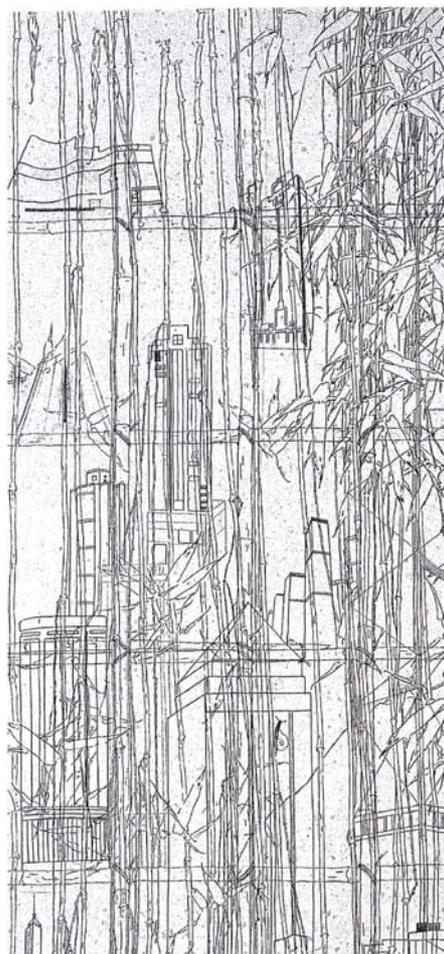
As we have pointed out, the dominant bourgeois view of China is that it is in a gradual transition to a 'free market economy'. Yet, for our fabian neo-liberals, this transition has not only led to economic prosperity but also holds the promise of democracy. For them the 'free market' necessarily leads to a Western-style liberal bourgeois democracy. However, those Western businessmen who are locked out of China's closed business world, and who look to democratic changes to give them a more 'equal and fair' access to the huge profits that can be made in China, are far less sanguine about China's supposed transition to a 'free market society'.

As many 'big bang' neo-liberals point out, China has been undergoing liberal economic reform for more than 25 years but in many respects is still no nearer the ideals of a Western bourgeois democracy. They bemoan the continued dominance of the state that still owns over half of the economy. Indeed they point out that although it declined in the late 1990s with the sell off of the smaller state-owned enterprises, with rapid growth the state's involvement in joint ventures with transnational corporations the proportion of capital owned by the state has now begun to rise again.

These 'big bang' neo-liberals warn that the China's rapid economic growth will become unsustainable due to mounting social tensions unless they can be contained through radical political reform and the dismantling of the one-party state. However, as we shall consider in more detail later, if their wish for radical political reforms came true then it could very well kill the goose that lays the golden eggs.

As we have seen, China's transformation and current rapid economic growth have not been brought about by the magic of the 'transition to a free market economy'. It is certainly true that the liberal economic reforms of the past twenty five years have led to an increase in the commoditification and monetarisation of the economic relations that has entailed an important change in the relation

of the state to capital accumulation from that which had existed under Mao. Yet this changed relation of the state to capital accumulation was only a necessary precondition for China's current transformation into a world economic power. The cause of this transformation has been the ability of the Chinese state to harness and direct foreign capital in the exploitation of China's vast labour-power through its integration into the global accumulation of capital. The has meant that the Chinese state has had to play a major role in maintaining social peace by containing the class struggle and in providing the material and social infrastructure necessary for capital accumulation. But not only this, it has also meant that the state has had to play a major role in retaining a large part of surplus-value produced by the Chinese working class for further national accumulation, overriding the short termism of the global finance markets - as China's survival of the East Asian crisis of 1998 clearly showed.



## **Part 2: China and the global accumulation of capital**

As we have argued in Part 1, China's current transformation, and its rapid economic growth, is the result of its integration as a distinct epi-centre in the global accumulation of capital. We shall now in Part 2, see how this integration into the world economy has so far served to not only to re-invigorate world capitalism but also reassert American economic hegemony, and then consider how China's position within global capitalism is likely to evolve.

We shall begin by considering China's impact on US economic hegemony.

### **The USA and the Global Accumulation of Capital**

In the late 1980s it had seemed to many that if the 20th century had been the 'American Century' then the coming century would belong to Asia. However, at that time it had not been China that was seen as being destined to displace the USA as the world's economic superpower - but Japan. The Japanese 'model' of capitalism, with its close connections between the state, the banks and the monopolistic industrial conglomerates, which had been forged through the defeat of Japan's working class after the Second World War, had transformed Japan into the world's second largest economy. With its pioneering forms of business organisation, its compliant workforce and its ability to assimilate and develop new technology for commercial ends, Japan's rise to economic dominance had seemed inevitable, particularly when compared with the apparently moribund state of the US economy.

From the 1960s the US economy had been losing ground to Japan and Europe. Slow growth in the productivity of labour combined with high wages had led to a decline in the rate of profit. Furthermore, the rather drastic attempts in Reagan's first term of office to cure this relative economic decline had seemed to have failed. A restrictive monetary policy had led to high interest rates and a highly over-valued dollar. This, it seemed, had only served to render vast swathes of American industry uncompetitive on the world market leading to plant closures, growing unemployment and a growing trade deficit, as exports declined and imports increased. At the same time, tax cuts for the rich combined with increased military spending, as Reagan stepped up the arms race with the USSR, had led to a growing public sector deficit. As a result, while the US had entered the 1980s as the world's largest creditor nation, it ended the decade as the world's largest debtor. Indeed, for many, the growth of the US economy was only being sustained by ever-greater injections of debt. A position only sustainable as long as the rest of the world was willing and able to lend to America.

With the fall of the Eastern Bloc, then, it seemed that having overthrown its great adversary - the USSR - America had reached the height of its powers and, unable to overcome the problems of its economy, was destined to enter a slow political and economic decline in the face of mounting competition from both Japan and Europe.

In 1990 the property bubble that had been building up in Japan over the previous years burst, exposing the underlying weakness of the Japanese economy. As a result Japan was pitched into a prolonged period of economic stagnation from which it has even now yet to fully recover.

In contrast, the US has gone from strength to strength. With hindsight the 'Reaganomics' of the early 1980s can now be seen to have been part of a major restructuring of the American economy that has served to reinvigorate capital accumulation. The decimation of American manufacturing industries that were rendered unprofitable in the face of high interest rates and an over-valued dollar allowed for a vast liquidation of capital previously fixed in these industries and its re-investment in the new industries based around the emerging electronic, communication and information technologies that were to form the core of what was to become known in the 1990s as the 'New Weightless Economy'. This shift from the old to the new industries was

further facilitated by high military spending through such projects as the Missile Defence system - otherwise known as Star Wars - which involved a huge and barely disguised state subsidy for research and development into the new information and communication technologies.

The shift from the old highly unionised manufacturing industries of the North East of the USA to the new largely non-unionised industries of the South and West served to outflank the entrenched positions of the American working class that had been built since the 1930s. As a result wage rates could be kept down while workers could be obliged to work longer hours - thereby increasing the production of absolute surplus value. At the same time, a more compliant labour force allowed more flexible working times, which when combined with the use of the new information communication technologies allowed for a more rapid turnover of capital. This, together with the falling value of instruments of production made possible by the cheapening of new technologies, was to lead to a sustained rise in the rate of profit of US capital from the late 1980s onwards. Indeed, by the end of the 1990s profit rates had reached levels not seen since the post-war boom years of the 1950s and 1960s.

Following the East Asian crisis of 1997-8, speculative capital that had sought quick returns in the 'newly emerging market economies' returned home to take advantage of the growing investment opportunities of the emerging 'New Economy'. Amidst much hype concerning how the new technologies, such as the internet, were going to revolutionise the world and how all the laws of finance and economics were being needed to be rewritten with the emergence of the 'New Economy', this influx of speculative capital fuelled the huge dot.com bubble of the late 1990s.

In 2000, the madness of the dot.com bubble - which at its height had seen dot.com companies, many of which had never made a profit and which employed merely a few dozen people, being given stock market valuations greater than General Motors - inevitably came to an end. The bursting of the dot.com bubble left many companies, including many outside the 'New Economy' which had become caught up in the irrational exuberance of the late 1990s, dangerously over extended. Saddled with the costs of servicing huge debts and the prospect of declining sales revenues, large swathes of American capital faced bankruptcy. The US economy was brought to the brink of spiralling into a deep economic depression that threatened to kill America's 'New Economy'-based resurgence in its infancy.

However, the US authorities were able to respond swiftly with the adoption of bold Keynesian reflationary policies to stave off the prospects of an economic depression. Firstly, within little more than six months, the Federal Reserve Bank cut its base interest rates from 6.5% to 1%, throwing a vital line to many over extended capitals at the same time as shoring up the collapsing American stock market. Then, following his election, Bush (jnr) pushed through a series of substantial tax cuts, mainly to the benefit of the rich. These tax-cutting measures combined with a substantial increase in military expenditure, saw a sharp growth in the government deficit. In the last year of Clinton's second term in office there had been a budget surplus equivalent to 2% of GDP. Four years later this had turned into a budget deficit of 4% of GDP.

As a result of the US authorities' reflationary policies the American economy was able to ride out the

aftermath of the dot.com crash with little more than a mild recession. Now, five years after the bursting of the bubble, the US economy is growing at more than 4% a year, unemployment has been steadily falling for more than two years, the US dollar is strengthening and inflation remains low. With the core economies of Europe - France, Germany and Italy - still struggling to recover from recession, and Japan yet to make a sustained escape from more than fifteen years of economic stagnation, the US appears to have been able to reassert its position as the world's dominant and most dynamic advanced capitalist economy.

However, it is often argued that the current dynamism of the US economy has been based on an unsustainable debt-fuelled consumer boom, which has served to hide the essential weakness of capital accumulation in the USA. Indeed, the last fifteen years has been seen as the indian summer of the USA. The twilight years of American hegemony in which the US increasingly finds itself dependent on its dominant financial position built up during its heydays to disguise the hollowing out of its economy, providing one last period of prosperity. Sooner or later it is argued, the rest of the world will stop lending the US money and this indian summer will be brought to an end.

Of course, it is certainly true that the US economy has been sustained by a prolonged debt-fuelled consumer boom. Cuts in taxes have provided the rich with plenty of money to spend. At the same time, low interest rates have led to a speculative house price bubble in recent years that has allowed American house owners to borrow against the rapidly rising valuation of their homes. As a result not only has government debt moved sharply in to the red but also personal indebtedness has risen to unprecedented levels.

At the same time, the rapid growth in consumer demand has been met by a continuing flood of imports, not least from China, which has led to a substantial balance of payments deficit. Both the consequent balance of payments deficits and the government's budget deficits have been largely financed by borrowing abroad.

But has this prolonged debt-fuelled consumption binge placed the US economy in a perilous financial position? Is it simply a matter of time before the goodwill of America's foreign creditors, who up to now have been prepared to accept US dollars and dollar denominated financial assets used to finance US debt, becomes exhausted? Have the reflationary policies pursued under Bush (jnr) merely delayed a crisis that will inevitably expose the decline of US capitalism?

It is certainly true that over the past four years both the total accumulated debt of the federal government, and the debts America as a whole owes to foreigners, have risen sharply. Between 2000 and 2003 the total debt of the federal government had already risen by more than a quarter to top \$4 trillion. Meanwhile the total debt Americans owed the rest of the world rose to over \$10 trillion; while net debt (the difference between what Americans owe the world and what the rest of the world owes the USA) rose in these three years by 60% to more than \$2.6 trillion<sup>9</sup>.

However, while these figures may appear astronomical in magnitude, this is to ignore the sheer enormity of the US economy. The federal debt is still less

than 40% of US GDP, which is comparatively low both by international and historical standards. The European stability pact, which is considered quite restrictive, requires states participating in the Euro to keep government debt to less than 60% of GDP and their public spending deficits to less than 3% of GDP. Following the huge deficits run up by Reagan in the 1980s the Federal debt stood at over 50% in the early 1990s. However, concerted attempts to reduce the government's budget deficits under both Bush (snr) and Clinton allowed inflation and economic growth to reduce the burden of Federal debt to less than 35% in the year 2000. The net foreign debt accumulated by the American economy as whole at \$2.6 trillion is still less than 25% of US GDP. Furthermore, due to the dominant position of the US in the global financial system, the rates of return the US earns on the investments and loans it makes to the rest of the world is on average greater than the rate of return it has to pay on its accumulated debt. As a consequence, there still remains a net inflow of investment income into the USA. Hence, the USA has yet to reach even the brink of the slippery slope where it would have to borrow in order to pay the interest on its debts.

In short, then, although the rate of increase of indebtedness in the US economy over the past four years is no doubt of some concern, the American economy is still financially sound. Indeed, it would seem it still has a long way to go before the alarm bells would need to be sounded. Yet, although it may be financially sound at present, it is certainly the case that the growth of the US economy cannot be maintained forever by a consumer boom sustained by ever increasing doses of private and state debt. However, the indications are that will not need to be.

The frenzy that accompanied the dot.com boom in the late 1990s had spread far beyond the 'New Economy' of information and computer technology companies. It was widely believed that the dynamism of the dot.com revolution had radically altered all the old rules of economics and finance and offered those which were bold enough to invest quickly with the prospect of enormous profits. Consequently, American corporations, large and small, borrowed to invest on a massive scale. As a result, once the dot.com bubble burst, American businesses found themselves with huge claims on their profits in the form of interest payments and share dividends, at a time when the prospects of future profits were being substantially downgraded. Although most of the virtual dot.com companies were swept away, the sharp cut in interest rates made by the Federal Reserve Bank allowed most of established corporate America to stave off bankruptcy.

Having survived the dot.com crash US capital embarked on a period of rationalisation and cost cutting, which was to result in a sharp increase in unemployment between 2001 and 2003. As those remaining in work were made to work harder and longer the introduction of new technology was used more rationally to cut costs and increase the turnover of capital. As a result, the rate of profit of the US has recovered its upward trend. So far much of the increase in profits has been used to restore the financial position of 'corporate America'. Debts have been repaid and stocks and shares have been bought back, thereby retiring fictitious capital to bring the paper claims on future surplus-

<sup>9</sup> These figures are derived from IMF *International Financial Statistics* (2004). (n.b. A trillion is an American trillion i.e 1,000,000,000,000).

value back in line with realistic prospects of producing and realising surplus-value in the future.<sup>10</sup>

As the financial position of American capital is restored the conditions are being put in place for renewed investment in the expansion of real productive capital. Indeed, there are indications that such investment-led growth is already beginning to take off. Unless derailed by a sharp contraction in consumer demand arising from the bursting of the house price bubble or continued rising oil prices, it seems likely that the next few years could see an investment-led boom based on a self-sustaining real accumulation of US capital.

The fact that foreign investors have been prepared to retain investments in the US economy despite the fall in the US dollar by more than 30% over the past four years shows their continuing confidence in the basic soundness of the US economy. Indeed, huge debt should perhaps be taken as a sign of the strength, not the weakness, of American capitalism.

Firstly, despite the growing religious irrationalism of the mass of the American population, ably reflected in the facile born-again Christianity of many in the Bush administration, the USA remains the world centre of science and technology. US companies remain at the forefront of most of the cutting edge technologies, allowing them to capture surplus profits by being first in the field with new commodities. Secondly, despite the restructuring of the 1980s, the US still retains a wide ranging industrial base. In most industrial sectors the productivity of the American worker is greater than his counter-parts in other advanced capitalist countries. Thirdly, the American market is by far the largest unified market in the world. The value of commodities produced and sold in the USA is substantially greater than total value of commodities traded internationally making the USA the centre of world trade. But the US is not only the largest market for commodities, it also by far the largest centre for money and finance capital.

Of course, it is true that America's lead in science and technology is not as great as it was in the 1950 and 1960s. The German and Japanese workers have become almost as well-equipped as their American counter-parts. However, with the entrenchment of the European working class, the American capitalists are able to make their workers work longer and more flexibly. This may not last forever. As the vast reserve army of Eastern Europe becomes integrated into the European Union it is being used to undermine the entrenched positions of the working class in Western Europe. However, for the time being the US remains the global centre for the production, realisation and appropriation of surplus value. As such, it is the foremost economic power; industrially, commercially and financially. And hence, for the foreign investor, the USA remains the place where there is most money to be made.

So, following the restructuring of the 1980s, the US has reasserted its position as the centre of world capital accumulation. With the challenge from its nearest rivals - Japan and Europe - for the most part stalled, what are the

prospects of China coming up from the outside to mount a serious challenge to US hegemony? To answer this we must first see how China has so far become integrated into world capital accumulation over the past decade or so and what this has meant for economic relations with the USA.

#### *China and the Global Accumulation of Capital*

An essential element in the restructuring of capital accumulation in the 1980s, and one that was crucial for outflanking the entrenched positions of the working class in the advanced capitalist economies, was the relocation of productive capital to what were to become known as 'Newly Industrialising Countries' in the world's economic periphery.

This relocation of productive capital largely involved two distinct types of manufacturing production. Firstly, there were the mature, often relatively labour-intensive industries, in which the scope for further improved production methods was limited or prohibitively expensive. Such industries included textiles, clothing, shoes and toys. Secondly, there was the location of new and rapidly developing industries that were emerging around information, communication and computing technologies supplying components and hardware. Both of these types of manufacturing played an important part in what was to become known as the 'Asian economic miracle' as a dynamic process of capitalist accumulation occurred, first with Japan at the end of the 1980s and then increasingly with the USA in the 1990s.

As we have seen, in the wake of the devastating financial and economic crisis that hit the 'East Asian tigers' in 1998, China began to restructure Asian accumulation to its own ends. China had originally entered the Asian system of capital accumulation in the mid-1990s by taking over the more labour intensive assembly stages of East Asian commodity production. As a result, as China began to enter the assembly stage in more lines of production, increasingly commodities produced in Asia became funnelled through China, usually on their way to the great US market. Although this meant that other Asian countries lost productive capital involved in the final assembly stages to China, this was often more than made up by the fact that the lower costs of Chinese assembly production allowed lower prices for the final product, and thus greater sales.

However, in addition to such diversification, China has increasingly since 1998 'moved up the product chain', that is it has taken over more and more of the stages of the manufacturing Asian commodities destined for the US and World markets. As a result, Asian manufacturing industry has been relocated and concentrated in China. This relocation of manufacturing capital in China has had a particular severe impact on the former East Asian tigers, which in the 1990s had been the hub of Asian 'economic miracle' and a primary destination for Western investment in 'newly emerging market economies'. However, the loss of manufacturing has been compensated by China's ever growing demand for raw materials. Reverting to their traditional, pre-1990s exports, former 'East Asian tigers' have joined with many other countries across Asia, and even as far away as Africa and South America, in feeding China's seemingly insatiable appetite for raw materials and primary commodities.

Yet this is not all. As China has 'moved up the product chain' to take over more complex stages of production its demand for machine tools and other industrial equipment has increased. This demand has been met by

<sup>10</sup> The retirement of fictitious capital is indicated by both the figures of outstanding commercial paper and share buy backs. In the two years following the bursting of the dot.com bubble the value of outstanding commercial paper (i.e. debts of corporations) fell by nearly a quarter from \$1.6 trillion to \$1.2 trillion. Since 2001 share buy backs have risen from \$70 billion to nearly \$120 billion.

imports from China's more technologically advanced neighbours, South Korea and Japan. Indeed, the growth of exports to China has now become Japan's main hope of eventually ending its fifteen years of economic stagnation.

As a result, China is emerging as a distinct epi-centre in the world accumulation of capital. Indeed, as China overtakes the USA to become Japan's biggest trading partner, even the economically mighty Japanese seem set to be drawn into the Chinese orbit. The question that now arises is how does this distinct epi-centre of Chinese-Asian capital accumulation relate to the world accumulation of capital centred in the USA and Europe?

Squeezed between a falling rate of profit and an entrenched working class within the advanced capitalist economies, capital in the 1970s and 1980s had been driven to seek out sources of cheap and compliant labour-power around the world. However, it was not enough to simply find cheap and compliant reserves of labour-power - there were plenty of such reserves throughout the 'developing world' - it was also necessary that the social productivity of labour could be raised to levels comparable with that prevailing in the advanced capitalist economies. The authoritarian regimes of East Asia had been able to provide such essential pre-conditions for the re-location of manufacturing capital. Not only were East Asian economies able to provide cheap and compliant labour-power, but, after several decades of protected national accumulation of capital that had been permitted during the Cold War years, they had developed the essential economic infrastructure that ensured that the social productivity of labour was high enough to compete on the world markets.

As a result, the 'Newly Industrialising Countries' of East Asia became one of the primary sites for the relocation of manufacturing capital. By making East Asian workers work longer and harder for less pay than their Western counter-parts capital was able to raise the rate of exploitation and reverse the decline in the world-wide rate of profit. China has been able to take over the lead in Asian capital accumulation because it has been able to provide these basic requirements on a far larger scale. With a fifth of the world's population, and after five decades of rapid national accumulation of capital, China has not only a vast potential reserve of cheap labour-power but can also provide the economic infrastructure necessary for the high social productivity of labour. As such, the integration of China into global capitalism has given great impetus to the accumulation of capital following the restructuring of capital in the 1970s and 1980s.

In the first instance, the gains made by the increase in the rate of exploitation take the form of surplus-profits (that is profits that are above the average that can be expected on a given advance of capital) which emerge from the difference between the international market price of a particular commodity and the production price in China. These surplus-profits are captured first of all by the transnational corporations involved in the joint ventures in China and by the Chinese State. However, importers, such as Wal Mart, who provide access to Western markets, are also able to take a substantial cut of the surplus-profits. Thus, those capitals in the advanced capitalist economies that are able to do business with China are able to gain a substantial proportion of the surplus-profits generated.

However, as Chinese production of any particular commodity expands and takes a larger share of the world

market the international market price of that commodity will fall towards the price of production prevailing in China. In this way the gains of the increased level of exploitation of Chinese labour-power is generalised through the falling costs of both the means of production and the cheapening of the means of subsistence. Indeed, the increase in the production of manufactured commodities in China has placed considerable downward pressure on manufactured prices in general. This disinflationary pressure has played a major role in curing the endemic inflation that had built up during the period of intense class conflict and restructuring of the 1970s and 1980s in the advanced capitalist economies.

The 'threat of Chinese competition' has been used as an argument in the advanced capitalist economies to press for the adoption of neo-liberal policies and for more 'flexible' working practices. However, despite such arguments, the flood of Chinese imports into the advanced capitalist economies in general, and into the USA in particular, has so far not displaced much existing productive capital, and as a consequence, its impact on employment has been largely marginal. The reason for this is simple. The manufacturing capital, and jobs that went with it, were largely re-located to Asia during the restructuring of the 1980s. Chinese imports do not, therefore, compete with commodities produced in the advanced capitalist economies.

The emergence of China, and its integration within the global accumulation of capital, has served to prolong and deepen the reinvigoration of capitalism, which has resulted from the restructuring of the 1970s and 1980s. In addition China has also served to aid the American recovery from the dot.com crash, which had threaten to derail this reinvigorated capital accumulation in both the USA and in the world as a whole.

As we have already mentioned, in response to the dot.com crash the Federal Reserve Bank of the USA drastically cut interest rates from 6.5% to 1% in little more than six months. This made the US less attractive to foreign investors and the inflow of foreign capital consequently began to decline. As a result, there was downward pressure on the US dollar. Indeed, in the next three years the US dollar fell by more than 30% against the Euro. This made the US more competitive against its European rivals and helped to shift some of the deflationary burden of the dot.com crash onto Europe. However, such a sharp cut in interest rates would have threatened to put the US dollar into free fall if it were not for the central banks of China, Japan and other Asian countries buying up surplus dollars in order to maintain a fixed exchange rate between the dollar and their own currencies. Indeed, in its efforts to keep the yuan pegged to the US dollar the Chinese central bank alone has been obliged to buy up almost half a trillion US dollars over the past four years.

Furthermore, the Federal Reserve Bank was only able to sustain such low rates of interests in the face of rapidly rising government budget deficits, caused largely by tax cuts and greater military spending, because the Chinese and other Asian central banks were prepared to convert the dollar bills they had accumulated to prevent their currencies rising against the US dollar into US treasury bills issued to finance US government debt. Thus, in effect, China played a major role in the financing of the reflationary policies that averted a major depression following the 'irrational exuberance' of the dot.com boom.

China has emerged as a distinct epi-centre within the global accumulation of capital. As such it has established a relation of mutually re-enforcing growth with the advanced capitalist economies in general, and particularly with its main trading partner - the USA - in particular. Furthermore, China has played an important role in sustaining America's dominance within global capital accumulation. Indeed, up until now, far from challenging US economic hegemony, the emergence of China has served to consolidate it!

The question that now arises is what political or economic factors may serve to disrupt the largely benign relations between China and the US, which have arisen from mutually re-enforcing capital accumulation. The first problem is the competition over scarce natural resources.

### Competition over scarce resources

Two of the most recurrent themes that are to be found in Chinese foreign policy pronouncements in recent years have been the necessity to establish a 'multi-polar world', and the insistence on the non-interference in the affairs of sovereign nations. Both themes have been deployed in various diplomatic initiatives through which China has sought to build alliances amongst 'developing states' to counter the encroachments of US hegemony. Indeed, these themes have become part of what has become known as the 'Beijing Consensus', which is presented as an alternative to the evangelical neo-liberalism of the 'Washington Consensus', which has been widely seen as attempting to universalise American-style capitalism and democracy.

However, as the Chinese foreign policy makers well recognise, China is in no position, at least at present, to seriously challenge US hegemony, nor contest the basic tenets of its neo-liberal ideology. Indeed, in signing up to the WTO, China can be seen to have made an irreversible commitment to the principle of progressive liberalisation of trade and the free movement of capital. It has become a respected member of the international bourgeois community and subscribed to the American-dominated New World Order, which has been established following the disintegration of the USSR. For China, the 'Beijing Consensus' simply asserts the right of 'emerging market economies' to pursue neo-liberal policies in their own way, with regard to their own political and social circumstances and traditions.

Indeed, having accepted the rules of the game, China has sought to turn them to its own advantage. China has sought to consolidate its economic position as the emergent centre of Asian manufacturing by promoting free trade agreements in Asia. It has established close diplomatic ties with the countries of South East Asia both directly, and through the Association of South East Asian Nations (ASEAN) has gained limited access to the ASEAN Free Trade Area.<sup>11</sup> Similarly, China has established close diplomatic and economic ties with the countries of South Asia and as a result has been granted 'special partnership status' with the South Asian Association for Regional Co-operation (SAARC) and the associated South Asian Free

Trade Area.<sup>12</sup> Further afield, China has made bilateral trade agreements with Brazil to secure food and raw materials.

In the WTO, China, along with India and Brazil, has led a loose coalition of 'developing economies' that have succeeded in challenging the priorities for liberalisation promoted by the US and Europe. This coalition, sometimes known as the G20, succeeded in blocking the most recent round of trade liberalisation proposed at Cancun in 2003. And, in doing so, has insisted that the countries of the 'North' should, as a matter of priority, dismantle the high levels of protection afforded to their farmers.

Diplomatic efforts to promote 'common security', economic co-operation and free trade can be seen to be in perfect accord with the multilateralism of the 'new world order'. However, it is precisely the ability of potential long-term rivals to America's hegemony to turn the 'new world order' to further their own ends that has strengthened the case of the neo-conservatives within the Bush administration. The neo-conservatives argue that if the USA is to maintain its world hegemony it must be prepared, where necessary, to cut through the diplomatic entanglements that have grown up with the 'new world order' to unilaterally assert its strategic and economic interests. Nowhere is this seen as being more necessary than over securing the supply of raw materials, particularly oil - as the Iraq war has clearly shown.

### *China's demand for energy*

Over the last fifteen years China has not only experienced rapid export-led growth in manufacturing, requiring the building of new factories and increasing amounts of inputs of raw materials, but also a long-sustained construction boom as whole cities have been summoned into existence. As a result, China's demand for raw materials to feed its rapid growth has soared. But China's rapid economic transformation has not only required vast and ever increasing quantities of raw materials but also increasing amounts of energy. Indeed, in the last two years energy shortages have become a major barrier to continued capital accumulation - as China's economic planners concerned with the severe bottlenecks in the production and distribution of coal, electricity and oil are acutely aware. Thus, for example, despite the installation of 440GW of electric power generating capacity - more than the entire electricity generating capacity of the UK, France and Germany combined - demand for electricity has still outstripped supply.<sup>13</sup> As a result, the last two years have seen serious power cuts in the more rapidly growing Southern provinces. Reckless attempts to keep up with the increasing demand for coal for electricity generation have led to a number of serious mining disasters. In the first six months of 2005, 2,672 miners were recorded as having died in mining accidents - forcing the government to announce recently the temporary closure of a third of China's mines for safety reasons. While the recent rise in the price of oil, compounded with transportation problems, has led to severe petrol shortages.

Such bottlenecks in the production and distribution of energy in general, of course, in part reflects the more general problem facing China's economic planners of

<sup>11</sup> ASEAN includes the former East Asian tigers; Indonesia, Malaysia, the Philippines and Singapore, together with Thailand, Brunei, Vietnam, Laos, Myanmar (formerly Burma), and Cambodia.

<sup>12</sup> SAARC is made up of India, Pakistan, Bangladesh, Bhutan, the Maldives, Nepal and Sri Lanka. China has now been accorded the special status of 'dialogue partner' with SAARC.

<sup>13</sup> See 'China's Electric Power Sector Reaches Growth Limit', *Asian Times*, May 5th, 2005.

sustaining sufficient state investment in basic utilities and economic infrastructure to keep up with the rapid expansion of the export-oriented manufacturing sector. However, it also involves the longer term problem of securing adequate supplies of oil. Although China has ample reserves of coal to meet the expected growth in demand for electricity generation, it has become increasingly dependent on imported oil to meet the needs of increasing road transportation. In 1994 China imported only 6% of its oil demand, by 2004 this had grown to 42% and is expected to grow to 60% by 2014. With its demand for imported oil expected to double within the next ten years, China's state planners have become anxious to secure foreign supplies of oil.<sup>14</sup>

As China is obliged to look to the rest of the world for its future oil supplies, it finds the world oil industry in a highly uncertain state of transition.

#### *The shifting geo-politics of oil and oil rents*

By the mid-1990s it was becoming increasingly clear that that the major oil fields of the North Sea and Alaska had reached their peak of production and that within a decade they would be in decline. As a consequence, the era of excess capacity in the world's oil industry, which had originated in the massive over-investment in the industry in response to the 'oil shocks' of the 1970s, would come to an end. With other Western oil fields due to follow suit soon after, the world's oil industry would increasingly become dependent on what has now become known as the Broader Middle East; that is the oil fields of the Persian Gulf, the Caucasus and Central Asia.

During the era of excess oil capacity US policy with respect to oil was to prevent a collapse in the oil price that would mean the ruin of America's own high cost oil industry. To this end the US sought to keep oil off the world market. The Americans backed Saudi Arabia's efforts to police the strict OPEC oil quotas and sought through war and economic sanctions to prevent the development of the major oil fields in Iran and Iraq.<sup>15</sup> However, with the prospect of this era coming to an end, it was necessary, if the US was to maintain its dominance in the world's oil industry, to develop a strategy to manage the transition to the new era.

The strategy that evolved under the Clinton administration was firstly to open up the oil fields of Iran and Iraq to American and Western capital investment. This was to be done either by diplomatic efforts to persuade the governments of Iran and Iraq to take a more pro-Western position, or failing this to bring about a regime change in these two countries through covert operations. Secondly, in conjunction with the opening up of the oil fields of Iraq and Iran, Clinton's strategy was to take the opportunity of the disintegration of the USSR and the privatisation of the Russian oil industry, to gain access for US oil companies in Russia, the Caucasus and Central Asia on favourable terms.

However, Clinton's oil strategy was overtaken by events. Following the oil shocks of the 1970s, the development of new sources of energy and energy-saving technology, together with slow economic growth, meant that

throughout the 1980s and the early 1990s the world demand for oil barely grew. As a result, the main cause of the prospective decline in the excess capacity of the world's oil industry was seen to be on the supply side: that is the decline in the supply of oil from aging oil fields. As such, the expected point at which the era of excess oil was due to come to an end was sometime around 2010 giving plenty of time for the prising open of new oil fields. But from the late 1990s world demand for oil began to rise sharply. A large part of this increase in demand coming from the unexpected rapid economic growth of China. As the recent sharp rises in the price of oil have confirmed, the oil crunch has come far sooner than was expected ten years ago.

As it became clear that Clinton's long-term strategy was being overtaken by events, the position of the neo-conservatives with the American foreign policy establishment became strengthened. Following the attack on the Twin Towers in September 2001, the neo-conservatives within the new Bush (jnr) administration took the opportunity to press for a radical change in US foreign policy. In open defiance of the multilateralism of established American foreign policy, they argued that it was necessary to cut through all diplomatic entanglements so as to unilaterally re-order the geo-politics of the broader Middle East by sheer military force.

Firstly, with the invasion of Afghanistan in 2002, the US was able to obtain a foothold in Central Asia, which up until then had been accepted as being within the Russian sphere of influence, not only by occupying Afghanistan but by the establishment of military bases in the Central Asian republics. Secondly, the invasion of Iraq not only allowed the US to occupy a country with the world's second largest known oil reserves but placed it in a position both to shore up, by military force if necessary, the pro-American Saudi regime - which of course presides over the world's largest known oil reserves - and to intervene to overthrow the anti-American Iranian regime.

However, the neo-conservatives' bold but reckless plan to resolve the problem of continuing America's dominance of the world's oil industry by forcibly re-ordering the geo-politics of the 'broader Middle East' has failed. It has run into the sands of the Iraqi resistance. Far from projecting US military power, and showing the world that it has exorcised the ghost of Vietnam, Iraq has shown the limits of US power. In doing so it has opened up what has become known as the 'new great power game' over control of the production and distribution of oil - and the oil rents that arise from such control - of the largely untapped oil fields of Central Asia.

#### *The great power game*

The main players in the new great power game<sup>16</sup> in Central Asia are, firstly; the main advanced capitalist powers: the USA, whose transnational oil corporations dominate the world's oil market, the powers of Western Europe, and Japan. Secondly, there are the main Asian powers whose close proximity to Central Asia enhances their geo-political position: China, Russia and India. Thirdly, there are the five

<sup>14</sup> See 'Pressure on Beijing Over Fuel Shortages', *Financial Times*, August 18th, 2005.

<sup>15</sup> For our more detailed analysis of the geo-politics of oil and the recent Iraq War see 'Oil Wars and World Orders Old and New', *Aufheben* #12, 2004.

<sup>16</sup> The 'great power game' was originally coined to describe the diplomatic and military manoeuvres between Russia and Britain for control of central Asia in the 19th century. It was a phrase erroneously attributed to Rudyard Kipling, who made it famous in his novel *Kim*.

Central Asian states: Kazakhstan and Turkmenistan, who along with Russia are sitting on most of the oil and natural gas deposits, together with: Uzbekistan, Tajikistan and Kyrgyzstan who are all strategically situated for anyone wishing to control the distribution of oil in the region.

As the US has become bogged down in Iraq, the Chinese state has pursued a complex set of diplomatic, commercial and military initiatives to secure its future oil supplies and to advance its corporations' positions in capturing oil rents. Central to these initiatives has been a series of diplomatic manoeuvres designed to create an Asian bloc that is able to oppose the dominance of the US and Western oil interests in Central Asia.<sup>17</sup>

Perhaps the most important of these has been the wooing of Russia. Russia's recent recovery from the disastrous 'neo-liberal shock therapy' of the 1990s, which saw the Russian economy shrink by nearly 50%, has largely been the result of increased state control over the Russian oil companies - who are now at least obliged to pay their taxes - and the rising price of oil. Russia's dependence on oil wealth has meant that it is under strong pressure to exploit its position as a key player in the carve-up of the 'Broader Middle East'. Much of the undeveloped oil reserves in Central Asia lie either in Russian territory or in territory of the former USSR. The economic infrastructure, including oil pipe lines, of the former USSR republics of Central Asia, as far as they exist, is still largely integrated with the Russian economy. As a consequence, Russia is the gatekeeper of the Central Asian oil fields, controlling, as it does, not only the extraction of its own oil fields but also the transportation of much of the oil extracted within its former empire.

Since Hu Jintao took over from Jiang Zemin as China's pre-eminent leader late in 2002 he has visited Russia for high level talks on no less than five occasions. However, up until recently this seemed to have had little impact on Sino-Russian relations. With regard to oil, Russia has sought to build on the commercial relations with Western oil companies to gain the necessary investment and technology to exploit its reserves and in obtaining potentially lucrative contracts to supply European economies with oil and natural gas as the hydrocarbon deposits of the North Sea become depleted. More generally, although Russia opposed the US invasion of Iraq, Putin has thought it wise to maintain cordial relations with the US.

In order to strengthen its bargaining position with regard to Europe, Russia proposed to build a trans-Siberian pipeline to the Pacific, which would give it an alternative outlet for its oil. It allowed a bidding war between Japan and China over where the pipeline should end up and who should pay for its construction. In 2004 the Russians came down in favour of the Japanese bid.

However, following America's promotion of the 'Orange Revolution' in the Ukraine, which directly threatens Russia's oil interests in the Caucasus, Putin's foreign policy has seen a decisive turn towards China. This has become evident with the extensive joint military exercise held by China and Russia in August 2005 - the first such joint military exercise for more than fifty years.<sup>18</sup> These exercises

were preceded by the announcement on June 30th that the Russian government had agreed to have a branch of the trans-Siberian pipeline going to China, much to the annoyance of the Japanese.

The announcement that there would be a branch of the pipeline came on the eve of a summit meeting of the Shanghai Co-operation Organisation (SCO). A meeting that some analysts have seen as potentially having greater world significance than the far more publicised meeting of the G8 happening at the same time. The SCO was originally set up in 2001 as an intergovernmental organisation to promote co-operation over economic and security matters between Russia, China and four of the five Central Asian republics: Kazakhstan, Uzbekistan, Tajikistan and Kyrgyzstan.<sup>19</sup>

As far as economic matters are concerned China was interested in gaining access not only to the untapped oil and natural gas reserves of Central Asian republics but also to such raw materials as cotton, aluminium, zinc, lead, iron ore and gold. China also hoped that the Central Asian republics would provide close markets for the manufacturing industries planned for its economically undeveloped western regions.

As far as security was concerned all member states of SCO faced growing militant Islamic groups, which at the time were becoming bolder as the Taliban consolidated their control over Afghanistan, as well as various ethnically based separation movements. China had itself faced increasing incidents of ethnic rioting, political assassinations and the sabotage of oil-wells and pipelines in its far western autonomous region of Singang. Through the SCO it was hoped that co-ordinated action between the member states would be far more effective in cracking down on such 'terrorism' that was largely based in the mountainous border lands.

However, within months of the establishment of the SCO the situation in Central Asia was radically transformed by the US invasion of Afghanistan. Grasping the opportunity to break free from their traditional subordination to Moscow, the Central Asian republics rallied to the American-led 'war on terrorism'. In return for substantial amounts of military and economic aid, Uzbekistan and Kyrgyzstan allowed America to build air bases and station more than 3,000 troops on their soil, while Kazakhstan and Tajikistan agreed to let the US use their airspace for military over-flights.

The tentative proposal to build a 3,000 kilometre pipeline from Kazakh oilfields close to the Caspian Sea to China was put on hold. Instead the Kazakhstan government renewed its commitment to the American proposal for a pipeline running under the Caspian Sea then across Azerbaijan and Georgia to the Turkish port of Ceyhan. A pipeline that would provide an alternative to the existing pipeline that runs to the Russian port of Novorossisk on the Black Sea.

Yet, like Russia, the attitudes of the Central Asian republics toward the USA have gone through an abrupt about

<sup>17</sup> See 'China's Hunger for Central Asian Energy', *Asian Times*, June 11th, 2003.

<sup>18</sup> See 'Brothers in Arms Again', *Asian Times*, August 20th, 2005; 'Hu Jintao Seeks to Secure Deliveries of Russian Oil to Fuel

China's Economic Growth', *Mosnews*, June 30th, 2005 and 'China and Russia, New Shooting Stars', *Asian Times*, September 9th, 2005.

<sup>19</sup> Chien-peng Chung, 'The Shanghai Co-operation Organization: China's Changing Influence in Asia', *China Quarterly*, 180, December 2004; 'Hu's Central Asian Gamble to Counter the U.S. "Containment Strategy"', Willy Lam, *China Brief*, July 2005, Jamestown Foundation; also 'Energy: The Catalyst for Conflict', *Asian Times*, August 30, 2005.

turn over the past year. Under pressure from the Americans to open up their economies to the 'free market', and with the threat of US-sponsored 'orange revolutions' if they do not, the Central Asian republics have returned to the arms of China and Russia. As a result, SCO has been reinvigorated. At the meeting in July 2005 it was agreed that the pipeline between Kazakhstan and China would be built after all. In addition SCO called on the US to withdraw all its troops from Central Asia. Within weeks Uzbekistan followed this up by announcing that the American military bases on its soil would be closed. Only a lightening tour of the capitals of Central Asia by Donald Rumsfeld managed to stave off, at least for the time being, similar actions being taken to remove the American military presence elsewhere in the region.

Alongside its diplomatic initiatives aimed at Russia and the Central Asian republics, China has also attempted to build closer diplomatic ties with India, particularly over the issue of oil. Like China, India's recent rapid economic growth has required increasing imports of oil. As such, India is a potential rival with China over the carve-up of the oil reserves of Central Asia. However, China has sought to build on its common interest with India in challenging the 'Western dominance' of the world's oil industry. To this end China has entered a joint venture with India and Iran to develop Iranian oil production.<sup>20</sup> Furthermore, as a step towards the formation of an Asian bloc, there have been indications that India will participate in military exercises in 2006 with Russia and China.

At the commercial level, China's state-owned oil corporations have been busy buying up oil exploration and exploitation rights throughout Asia. The most audacious of such moves was the bid by China National Offshore Oil Corporation (CNOOC) to takeover the relatively small US oil company, Unocal. A takeover that was blocked in the name of 'American national interest'. Much of the opposition to the deal was based on the argument that the Chinese would be taking over American oil reserves. However, CNOOC had undertaken to divest itself of Unocal's interests in oil fields in America if the deal went through. The main interest of CNOOC in Unocal's was its oil and natural gas interests in Asia, such as its operations in Myanmar (formerly Burma), Bangladesh and Turkmenistan.

Although CNOOC's bid for Unocal was blocked, this has been compensated by another state-owned Chinese oil company - China National Petroleum Corporation (CNPC) - pulling off a US\$580 million deal to take over the Canadian registered Petro-Kazakhstan. Petro-Kazakhstan is the third largest oil producer in Kazakhstan.<sup>21</sup> This deal, together with the proposed pipeline, not only serves to further consolidate China's access to the oil and natural gas resources of Kazakhstan but also allows the capture of the oil rents arising from their extraction.

So, in short, in recent months the 'new great power game' to carve up the hydrocarbon reserves of Central Asia has shifted sharply against the US and in favour of China. This, together with the concerns aroused by the rising price of oil, has served to fuel the notion of an imminent Chinese

threat to America's interests in various quarters of the American bourgeoisie. This has manifested itself, not only in the strong opposition to the CNOOC bid for Unocal, but also in moves in the US congress to impose economic sanctions against China if it failed to revalue the yuan. From within the Bush administration itself, Donald Rumsfeld has publicly expressed his concerns at the growing military might of the PLA.

However, the 'new great power game' around Central Asia is at an early stage and the situation is still in a considerable state of flux. With both India and Russia keeping their diplomatic options open, both generally and in regard to oil, the consolidation of a cohesive anti-Western Asian bloc is still a long way off. Indeed, the situation could turn against China just as quickly as it has turned in its favour over the past months.

In Bush's dealings with China, the concerns over the 'Chinese threat' are likely to be used as little more than bargaining counters over minor matters. The Bush administration needs continued Chinese co-operation in containing North Korea. It also shares with the Chinese government common interests in resisting calls from Europe for reduced carbon emissions to avoid climate change, and both governments have a common cause in opposing proposals to expand the UN Security Council.

However, much more importantly than such common foreign policy interests, is the fact that Bush cannot ignore the interests of American capital in making profits out of the rapidly expanding Chinese economy. So long as the relation between China and the US remains one of mutually re-enforcing capital accumulation the prospect of direct military confrontation remains remote.

Indeed, as we shall now argue, the best prospect for the US to head off the long-term threat of China to its hegemony would seem to be, not neo-conservative-inspired military adventures to either contain or even confront China, but the Trojan horse filled with neo-liberal ideologues.

#### *Trojan horses?*

For American bourgeois commentators there are two salient concerns regarding China's current stage of liberalisation and integration into the 'global economy'. The first, and most prevalent, is the issue of the exchange rate of the yuan to the US dollar. The second is the tardiness of the Chinese authorities in bringing about financial and banking reforms. As we shall see, both of these issues are interconnected, being aspects of a more fundamental contradiction in the current state-directed national accumulation of capital in China.

After mounting pressure from the US, it was announced on July 21<sup>st</sup> 2005 that the Chinese monetary authorities had decided that, after ten years, they would no longer seek to keep the exchange rate of the yuan with the US dollar fixed within a narrow band. Instead of pegging the yuan to the US dollar it would from now on be pegged to the basket of the world's most prominent currencies.<sup>22</sup> However, this concession has so far only resulted in a modest 2% appreciation of the yuan against the US dollar, far short of the 30% or so appreciation of the euro that has occurred in the last few years.

<sup>20</sup> See 'China's Foot in India's Door', *Asian Times*, August 24th, 2005; and 'India and China: Comrades in Oil', *Asian Times*, August 19th, 2005.

<sup>21</sup> See 'Kazakh Oil Coup for China, India Cries foul', *Asian Times*, August 24th, 2005.

<sup>22</sup> See 'Aim is to Allow Greater Flexibility While Still Keeping Control', *Financial Times*, July 22nd, 2005; also 'Exchange Rate Reform in Long-Term Interests', *China Daily*, July 22nd, 2005.

For the US populist protectionist lobby, which has been most vocal and politically active in raising this issue, China's insistence in pegging the yuan to the US dollar has given China's exporters an unfair trading advantage. This, it is argued, is evident in China's growing trade surplus with the USA. If the Chinese authorities refrained from interfering in the foreign exchange markets, and thereby allowed the yuan to appreciate to its market level, then the large imbalance of trade between China and the USA would be eliminated. Given China's refusal to follow such a free market policy with regard to its currency, then the US government should intervene to 'level the playing field' by imposing tariffs on Chinese imports, so as to protect 'American jobs'.

In response the Chinese point out that although China has a substantial trade surplus with the US, this is offset by an equally substantial trade deficit with the rest of the world. Indeed, in 2004 China had an overall trade deficit. This, it is argued, shows that the problem is not the overvaluation of the yuan, but the failure of American companies to produce what the Chinese consumer wants to buy, and hence the failure to increase American exports to China so as to reduce the trade imbalance between the two countries.

Of course, it is certainly true that the flood of cheap Chinese imports into America in recent years has driven many small businesses to the wall and has accelerated the decline of certain industries and industrial areas in the USA. This impact on 'American jobs' has served as a rallying point for a politically potent populist alliance between sections of the industrial bourgeoisie, the petty-bourgeoisie and sections of the working class. However, for the American bourgeoisie as a whole this 'loss of American jobs' is of little concern compared with the lucrative opportunities continued Chinese capital accumulation is opening up.

Indeed, the Chinese response to the arguments of American protectionists enjoys a certain sympathy amongst the American bourgeoisie and their neo-liberal propagandists. However, having said this, many among the American bourgeoisie have their own reasons for wanting an end to a fixed yuan exchange rate, seeing it as a means to prise open China's barriers to the free movement of capital. As a result, they have advanced their own distinct and perhaps more seductive reasons for the Chinese authorities to abandon their efforts to manage its currency.

In contrast to the populist arguments that the pegging of the yuan to the dollar has been against American interests, many neo-liberal ideologues argue that it has also been against China's own economic interests. It is pointed out that much of the surplus dollars coming into China, which are bought up by the Chinese central bank, are due to the inflow of American foreign investment rather than the result of China's trade surplus. By then using these surplus dollars to buy US government treasury bills, the Chinese authorities are in effect granting the US short-term loans, which are then used to finance long-term investments in China that have the prospect of giving far higher returns. Thus in the long term China is losing out on the difference between the interest received on the US treasury bills they buy and the future returns they will have to pay out on American investments. Indeed, it could be argued that China would be better off investing its growing foreign currency reserves in its own industries.

Of course, despite the beguiling simplicity of such arguments, the Chinese government has had its own good reasons for maintaining a fixed exchange rate between the yuan and the US dollar. If nothing else, by pegging the yuan to US dollar, the Chinese authorities have been able to maintain not only the level but also the rate of growth of exports to the USA. At the same time, as the yuan has fallen with the US dollar against the euro, Chinese exports have been able to open up more markets in Europe. However, perhaps more importantly, by maintaining a fixed exchange rate with a falling dollar over the past five years, the Chinese government has been able to mitigate the impact of increased foreign competition on its still largely backward and inefficient agricultural sector that has followed China's accession to the WTO.

However, the more esoteric reason, and one that most often features in the obscure pronouncements of the Chinese monetary authorities, is the importance of maintaining 'financial stability'. For the Chinese monetary authorities the importance of maintaining a fixed exchange rate, whether this is in terms of the US or a 'basket of leading currencies', is that it buttresses their attempts to control the influx of speculative moneyed-capital. Indeed, a fixed exchange rate together with strict capital controls has been vital in insulating the Chinese financial system from the destabilising tidal movements of global finance capital<sup>23</sup>.

#### *Financial Reform*

At the time of China's accession to the WTO many Western commentators had expressed serious doubts concerning the ability of the Chinese government to carry out the neo-liberal reforms within the agreed five year transition period. Indeed, many believed that China would end up reneging on what was after all a quite tough deal for the Chinese. However, in most areas of liberalisation and de-regulation of trade and industry the Chinese government has far surpassed such expectations and remains committed to the WTO agreements. Yet there is one sector of the economy that has been an exception and that has been banking.

It is true that the Chinese government has gone a considerable way in separating regulative and commercial functions in the banking system. The banks have also moved towards Western standards and procedures of accounting and have become less secretive about their financial position. Nevertheless, Western business commentators lament how Chinese bankers act more like state and party officials than as bankers, and, as a consequence, how political considerations continue to override commercial criteria in their decision making.

Western business commentators point out how this sub-ordination of the commercial to the political has resulted in an almost insurmountable problem of a vast and continuing accumulation of 'bad' or 'non-performing' loans. This, they argue, is due to the fact that banks are obliged to advance money to state-owned industry and local administrations for 'political reasons', giving insufficient regard either to whether the interest can be paid on these loans or even whether they can be paid back at all. Indeed, it has been estimated that 50% of all loans made by the major

<sup>23</sup> That the aim of western finance is the dismantling of capital controls is revealed in article by a senior economist at Westpac bank, see 'What About the Capital Account?', Huw McKay, *Asian Times*, July 26<sup>th</sup>, 2005.

Chinese banks are 'non-performing' - that is the debtors are unable to pay the interest due on them and have accumulated more than \$500 billion worth of bad debt!<sup>24</sup>

As a result, by Western standards most of the major Chinese banks would be considered insolvent, and would have been declared bankrupt long ago if it was not for the fact of repeated interventions by the state, both to re-capitalise the banking system and hive-off the bad loans of the banks' balance sheets to specially established state-owned Asset Management Companies.<sup>25</sup> Yet while such state interventions in the banking system serve to clean up the banks' current balance sheets from past bad loans they do nothing to prevent the generation of new bad loans. It is argued that the only way the problem can be solved is to reform the banks so that they operate according to purely commercial criteria. However, so far the Chinese government has been slow to bring about such reforms.

For Western commentators this slowness to reform the banking sector is puzzling given the government's commitment to reform in other sectors of the economy. It has been suggested that this reluctance to reform the banking sector is due to the importance of this sector for the political power games within the Party-State. As extensions of loans and credit are important in the allocation of resources within the state apparatus the control over banking policy is an important element in building up power bases within the Party-State bureaucracy.<sup>26</sup> No doubt this is certainly true as far as it goes. However, what this argument ignores is the vital importance of the current banking system for the state-directed national accumulation of capital.

The Chinese banks have more or less exclusive access through their branch networks both to the personal savings of China's vast and largely frugal population, and to the idle money balances of China's companies and corporations. They are therefore able to attract substantial savings deposits at very low rates of interest, which then form the basis of the banks' pool of loanable investment funds. Part of these loanable investment funds can then be lent out as commercial loans to the non-state sector at high commercial rates of interest. The high profit margins that are thereby made on these commercial loans then go to offset the losses the banks suffer on the other part of their loanable investment funds that they are obliged to lend at sub-commercial terms to state-owned enterprises and other state bodies. In this way the banks are able to provide the state with a very cheap source of funds that it can use for its own purposes.

Now, of course, there is a kernel of truth in the neo-liberal complaints that the state siphons off the investment funds of China's banks to provide 'politically motivated' subsidies to the 'inefficient and over manned' state-owned enterprises. As we have seen, central to their transformation into profit-orientated commercial corporations state-owned enterprises were to be shorn of their social functions in providing employment and welfare to their workers through

the *danwei* system. But this also meant an end to direct government grants and subsidies.

However, in order both to minimize and pre-empt class conflict, which has arisen from mass redundancies and the dismantling of the *danwei* system, the actual transformation of state-owned enterprises has become a long drawn out and frequently interrupted process. As a result, state-owned enterprises have found themselves still saddled with obsolete plant and machinery, continued obligations and commitments inherited from the *danwei* system and with an excess number of workers; but, at the same time, no longer able to obtain government grants and subsidies. To tide such state-owned enterprises over, or else enable them to invest in new plant or machinery in order to make the best of their restructuring, the banks have been obliged to advance them loans, even if the prospect of repayment may not be that great.<sup>27</sup> Furthermore, in cases where actual or potential resistance to the restructuring of state-owned enterprises may need to be bought off or else diffused, the banks have been required to advance, what are perhaps aptly named, 'peace & unity loans'.

To the extent that workers' resistance has delayed the transformation of state-owned enterprises into profit-orientated corporations then it has served to hold back reforms in the banking system. However, the financing of corporatisation is not the only function that the Chinese banks are obliged to perform within the state-directed accumulation of capital in China. They can also be seen as a means to ensure a more balanced capital accumulation.

In pursuit of the surplus profits that can be made on Chinese manufactured commodities sold on the world market, foreign direct investment in China has been largely concentrated in the export-orientated manufacturing sector. As we have seen, this direct investment has usually taken the form of transnational corporations entering into joint ventures with the Chinese state - with the state often retaining a controlling interest. Such joint ventures require the Chinese state to put up investment capital to match that of its transnational partners. This has meant that a large part of the state's investment funds, drawn from taxation and the dividends accruing from the state's share in capital in state-owned enterprises and joint ventures, is also committed to the export-orientated manufacturing sector. As a result, capital accumulation in this sector has tended to outstrip that of all other sectors of the economy.

However, rapid expansion of manufacturing requires the provision of cheap housing for its expanding workforce, it requires more roads, railways and harbours, it requires more power stations and a greater extraction of oil and coal, and the greater production of steel. Most of which are produced or provided by state-owned enterprises or other state bodies. However, the slow and often uncertain returns on major long-term construction projects; such as building roads, railways or power stations, are unattractive for private or foreign investors, particularly when the state is concerned to hold the price of industrial inputs, such as freight charges and fuel costs that such projects may serve to produce. Yet, with much of the state's investment funds committed to joint ventures in the manufacturing sector there is a shortage of

<sup>24</sup> See 'Banking Means Never Having to Repay a Loan', John Mulcahy, *Asia Times*, Aug 20 2003; and 'A Clearer Path Ahead for China's Banks?', George Zhibin Gu, *Asia Times*, July 2nd, 2005.

<sup>25</sup> See 'China's AMC Reforms Running Off the Rails', Qiu Xin, *Asian Times*, September 2005.

<sup>26</sup> See, for example, 'Dealing with Non-Performing Loans: Political Constraints and Financial Policies in China', Victor Shih, *China Quarterly*, 180, December 2004.

<sup>27</sup> These 'loans' can perhaps be seen as a sort of transitional form. Insofar as they have to be negotiated with the bank rather than a government office they are a loan, however, insofar as they are in effect non-repayable they are a hidden subsidy.

state capital for investment in such long term state sector projects. This has resulted, as we have seen quite clearly in relation to energy, in serious economic bottlenecks that threaten to derail China's rapid economic growth.<sup>28</sup>

Tapping the investment funds of the banks provides a way round this problem of relative under investment in the state sector. By obliging the banks to lend to state-owned enterprises and state authorities for long term investment in fixed capital formation the Chinese planners can make up some of the shortfall in investment in this sector.

Thus the partly unreformed Chinese banking system has functioned both to finance and smooth the process of corporatisation, and to ensure a more balanced accumulation of capital. But the question that now arises is: how much longer can the Chinese banking system function in these ways? What will be the impact of full implementation of the commitments to the WTO on banking reform?

In December 2006 the five year transition period for WTO reforms will come to an end. The Chinese banking sector is then due to be fully opened up for foreign banks. Already deregulation has led to the establishment of nearly two hundred foreign banks with branches in China. However, they have been so restricted that they so far only account for a mere 1% of China's saving deposits. Nevertheless, China is an enticing prospect for foreign banks and, once the remaining restrictions are lifted, there is likely to be a great rush to get in.

Of course, the free market ideologues have been keen to point out all the benefits China will reap with the opening up of its banking system to foreign competition. New 'financial products' and modern customer-orientated banking practices will be able to draw into the banking system more savings and promote more efficient and flexible finance to commerce, industry and the individual.

Certainly foreign expertise in 'retail banking' - that is dealing with the mass of private individuals - will certainly improve what has been a long neglected aspect of Chinese banking. With the constraints imposed by low wages and peasant incomes, the provision of ample and 'flexible' credit to the emerging Chinese middle classes will help to expand the home market.

Yet, the development of retail banking could end up diverting the loanable funds of the banks from financing real capital accumulation, in either the state or private sectors, to fuelling a consumer spending boom and bust. Thereby not only dragging down the rate of capital accumulation but also increasing the financial instability in the economy and the financial system.

Furthermore, foreign competition will also lead to higher interest rates that banks will have to pay out on savings deposits, and lower rates they are able to obtain on the loans they make. As a result profit margins for the Chinese banks are likely to be squeezed, making it more difficult for them to carry the burdens imposed by any sub-commercial loans they are obliged to make. Thus the ability of the banks to support capital accumulation within the state sector is likely to be impaired by increased foreign competition.

However, it must be said that the Chinese banks are not unprepared. Taking advantage of new rules that allow

foreign capital to own up to 25% of their shares, the Chinese banks have entered a number of deals with foreign banks. In return for a head start in the Chinese banking market, these foreign banks are to provide expertise in Western banking methods. Faced with the exclusivity and opaqueness of the Chinese business world foreign banks will find it difficult to make much headway in China's financial system without connections - giving the Chinese banks a strong hand in their negotiations with potential foreign partners. Indeed, the exclusivity and opaqueness of China's 'red bourgeoisie' is likely to blunt the impact of the foreign competition in banking, as it has in other economic sectors. Thus, although it is likely to cause problems financing capital accumulation in the state sector and exacerbate the problems of uneven economic growth, honouring the WTO commitments to banking reform is unlikely to cause a financial or economic crisis by itself.

However, what the issue of this banking liberalisation illustrates is the increasing dilemma China's economic planners face. China's rapid economic growth and development has been based on the flood of direct foreign investment. Yet while foreign capital is attracted by the potential profits that can be made, it is wary of the lack of bourgeois democratic norms in China. The lack of well-defined and established property rights, the absence of the 'rule of law' and legal protection from arbitrary government decisions, means that the security of investment sunk in real productive capital in China is dependent on the goodwill of the leadership of the CCP. But in the back of every foreign capitalists mind lurks the lessons of the history of the rule of the CCP, which shows there can be no ruling out of an abrupt policy reversal that might imperil their capital.

To allay such fears the Chinese leadership have sought to make clear their commitment to continued liberalisation and deregulation, and, in doing so, have been obliged to incorporate the neo-liberal nostrums into their own pragmatic ideology. Yet, as the tide of liberalisation and deregulation begins to reach beyond the banking system and into the financial system as a whole, continued liberal economic reform threatens to undermine the very core of China's state-directed capital accumulation.

Global finance capital is already banging on China's door, eager to stake a claim on the prospective profits to be made, either by buying into Chinese capital or else offering loans. Their propagandists are insisting on the inevitable progression of economic reforms leading to the abandonment of impediments to the free flow of capital such capital controls, and, as we have seen, with them fixed exchange rates. Yet such calls for the necessity of further liberal economic reforms are echoed inside China, not only by the Westernised intelligentsia, but also by China's red capitalists and 'bureaucratic entrepreneurs' who are eyeing up the vast potential source of investment funds available in the global money markets.

Yet, while pressure mounts both inside and outside for further economic reform that will allow the free flow of capital into - and indeed out of - China, it will become increasingly difficult for the Chinese state to bind the real accumulation of capital to the accumulation of money capital. The Chinese economy will become vulnerable to the instability of speculative financial capital flows. A sudden panic may well lead to a mass exodus of speculative capital, leading to a devastating crisis like that which swept the East Asian Tigers in 1998, only on a far larger scale.

<sup>28</sup> On the problems of financing China's economic infrastructure see 'Privatising the Iron Rooster', M. Mackey, *Asian Times*, June 18th, 2005.

### The future inter-regnum?

Up until now the emergence of China as a major force within the global accumulation of capital has not challenged the hegemony of the USA. Indeed, as we have argued, Chinese state-led export-orientated growth has in fact served both to bolster America's economic position and the tendencies towards the 'globalisation of capitalism' over which the USA presides. Of course, as we have observed, there may be serious pitfalls on China's upward path. But the question that now arises is, if China's red bourgeoisie can contain internal class conflict, maintain its current cohesion against the tidal forces of global finance capital and avoid conflicts with the USA over oil and other natural resources, can the present relation of mutually re-enforcing capital accumulation with America be sustained? Is it possible for China's economy to continue to simply and smoothly expand at its current breakneck pace until it overtakes Germany, Japan and eventually the USA to become the world's economic superpower? The answer is: most certainly not!

Already China produces 90% of the all children's toys and close to 60% of the world's clothing; it also produces, or at least assembles, 30% of the world's television sets, 50% of the world's cameras and 70% of the world's photocopiers. As China becomes the dominant Asian manufacturer the world prices of such manufactured commodities will be increasingly determined by their price of production in China. As world prices fall towards the Chinese prices of production the surplus profits, which arises from the difference between the two, will also fall. As a result, the vast inflows of foreign direct investment, which have been sucked in by the prospects of surplus profits, will begin to abate.

As a consequence, either the pace of capital accumulation in China will slow down, with perhaps unpredictable consequence for the containment of class struggle there, or else China will have to break into the production of commodities requiring more sophisticated and complex engineering and design. In entering such new hi-tech lines of production China will increasingly find itself in direct competition with the manufacturers in the advanced capitalist economies. In the competitive battle within these more hi-tech lines of production the availability of cheap simple labour-power will be far less of an advantage than it has been up until now. However, as a result of the state's investment in education over the last twenty years, China has built up a substantial base of scientists and engineers. Indeed, China and India combined are now turning out more university graduates than the USA and Europe, and, what is more, a greater proportion of these graduates are scientist and engineers.<sup>29</sup>

China's movement towards more high-tech production is perhaps exemplified by the emergence of the Chinese car industry. The development of a fully developed indigenous car industry has been a long standing objective of the CCP leadership's economic strategy. The last four years has seen considerable progress towards this end. Since

China's entry into the WTO, most of the world's leading car manufacturers have entered into joint ventures with Chinese corporations. As a result, car production, or at least car assembly, in China has expanded rapidly. In 2001 Chinese car production figures stood at one million a year; this had risen to five million in 2004, and is expected to pass ten million by the end of the decade.

However, up until now, China's emerging car industry has remained largely limited to assembling cars in order to supply its own domestic market. Yet, in its low wage economy, the demand for cars is for the most part restricted to China's affluent but relatively small middle classes. Given the vital importance of economies of scale to car production, it seems unlikely that the home market will be able to sustain sufficient demand in the long run to make a fully developed Chinese car industry economically viable.<sup>30</sup>

As a consequence, China will increasingly have to look towards exporting cars if it is to establish a fully developed car industry. But in doing so it faces serious obstacles. Firstly, up until now, the lack of economies of scale, due to low production volumes, combined with the high cost of importing components involved for assembly, has meant that China's low labour costs have been insufficient to make Chinese cars competitive in foreign markets.

Secondly, although they have been eager to exploit China's cheap labour-power to assemble cars, the world's major car manufacturers have been unwilling to share too much of their design, engineering and marketing skills with their Chinese partners - and possible future competitors - and have also been reluctant to transfer the manufacturing of key components to China. As a result, China's emerging car industry has so far lacked the means necessary to design, build and market its cars to break into overseas markets.

To overcome the problem of a lack of expertise in product design and development the Chinese state has encouraged state-owned car companies to buy in such expertise through the take over of ailing foreign car firms. An example of this was the recent take over of Rover MG. In the complex takeover negotiations between BMW and the two Chinese bidders for Rover - Shanghai Automotive Industry Corporation and Nanjing Automotive Corporation - it was clear that neither of the two Chinese companies were particularly interested in producing cars in Britain. Their primary purpose was to obtain Rover's vehicle and engine designs and its research and development skills.

To minimize the problem of a lack of economies of scale due to the restricted scale of its home base, China's car industry is concentrating on the export of upmarket luxury cars and SUVs. Early this year the Chinese car company Cherry announced plans to produce such upmarket vehicles to the US. By 2007 Cherry is planning to sell 250,000 vehicles in the USA and hopes this will rise to one million by early in the next decade. Nevertheless, the Chinese car industry, even with state backing, still faces an uphill struggle to break into what are already an oversaturated foreign car markets, particularly as it will have to face the exacting environmental regulations in the US and Europe.

Even if China eventually does break into the potentially lucrative markets of the USA and Europe it will not be for some time. Conception, design and the building of

<sup>29</sup> Perhaps an indication of China's growing research and development base is the rapidly rising numbers of patents that are being registered by Chinese universities. Last year 6,000 patents were registered, more or less the same amount as in the USA. See 'The West Must Heed China's Rise in the Global Patent Race', *Financial Times*, September 21st, 2005.

<sup>30</sup> It is estimated that only 2% of China's population - or about 30 million people - can afford a life-style comparable to the American or European middle classes.

car plants to produce new models aimed at new markets can take several years and with China only now beginning to turn towards large scale exports, it is unlikely that Chinese producers will be a major player, outside certain niche markets, until well into the next decade.

If China succeeds in winning the competitive battle over the production of hi-tech commodities, such as cars, then it will involve a further restructuring of world capitalism on a scale perhaps even greater than that of the 1970s and 1980s. Manufacturing capital in the USA and the other advanced capitalist countries will be faced with either bankruptcy or the relocation of their productive capital to low wage countries or even China itself. As industrial capital is relocated, the USA and the other advanced industrial economies will become 'hollowed out'. They will become rentier economies, increasingly dependent on the returns on their financial investments in China and elsewhere. The twilight years of US, and indeed European and Japanese, economic dominance will then have most certainly arrived.

Yet such a transfer of productive capital will also involve the wholesale transfer of manufacturing jobs and thus mass unemployment in the advanced capitalist economies. Consequently, China will find itself exporting consumer commodities that the unemployed workers in the West can no longer afford to buy. At this point, the world is likely to enter a major economic slump. In such circumstances of intensified economic competition we are likely to see a rise of protectionism and nationalism; which is likely to lead increasingly to trade wars, inter-imperialist conflict and war. The era of 'free trade and globalism', of a united 'international bourgeois community' and of the American-centred 'empire', which up until now the emergence of China has helped to sustain, will be brought to an end.

Yet, it must be said, that although the portents may already be evident, such a 'post-globalisation' period, and the terminal decline of US Hegemony, remains some way off in the future.

### Conclusion

So, will China be able to sustain its current rate of economic expansion? If so, can it eventually mount a serious challenge to American hegemony? What implications will this have for the class struggle?

As we have seen, in harnessing foreign capital in the exploitation of its vast working class, China has established itself as a distinct epi-centre in the American-centred global accumulation of capital. In doing so, it has so far established a relationship of mutually re-enforcing capital accumulation with the advanced capitalist economies, particularly the USA, which has served both to sustain its own rate of economic growth and that of the world.

With this virtuous cycle of mutually re-enforcing capital accumulation, it would seem likely that China will be able to maintain its current rate of economic growth, at least in the short to medium term. But does this mean that China will be able to overtake the US to become the world's new hegemonic power? This is far less certain. China has still a long way to go. China's economy is still only a fifth the size of that of the USA in terms of output and is still very much a 'developing economy'. In terms of GDP China may be

overtaking the UK to become the world's fourth largest economy, but this is to ignore its huge population. In terms of GDP per head China still ranks as one of the poorer countries in the world. Perhaps more importantly, as we saw with China's car industry, China is still very much dependent on both the technology and the expertise in engineering, research and development of the advanced capitalist economies.

Furthermore, the relation of mutual advantage between China and the USA, which has sustained China's rapid economic growth, will not last forever. As we have pointed out, conflicts may well arise between China and the USA over natural resources, particularly oil. Further liberal economic reforms may lead either to the dissolution of China's state-led national capital accumulation and its disintegration as a distinct epi-centre in the global accumulation of capital or else to it being torn apart by the tidal forces of global finance capital.

However, even if China avoids such pitfalls on the road to world hegemony, sooner or later - probably sometime in the next decade, the relation of mutual re-enforcing capital accumulation between China and the advanced capitalist economies will turn into its opposite. China will then have to either accept the place it has established in the world economic order, or else make its claim for world hegemony. It will then be that the battle will commence shattering the precarious unity of the world's bourgeoisie. Indeed, if this century is to become the Asian Century then it may well be as bloody as the last.

China's integration into the global economy has served to sustain the re-invigouration of the global capital accumulation that followed the restructuring of the 1970s and 1980s. The exploitation of the Chinese working class has served to restore the rate of profit and given fresh impetus to capital accumulation world-wide.

However, the British bourgeoisie has perhaps benefited from this re-invigoration of global capital accumulation more than most. An unprecedented period of uninterrupted economic growth, falling unemployment, low inflation and increasing real wages has allowed New Labour to consolidate and extend Thatcher's defeat of the old labour movement and re-negotiation of the post-war settlement. The ability to concede real material gains has allowed British capital to wean its working class from the remnants of its old collectivism and solidarity and re-integrate it as individual consumer/citizens. Yet, as we have seen, this period of relative bourgeois peace, prosperity and social tranquillity is only contingent and transitory. Indeed, we may well be past the meridian point of this period already.

However, all that we have said so far is contingent on the continuing exploitation of the Chinese working class. China's transformation has involved an immense re-making of the Chinese working class and the formation of a new industrial proletariat. In the next issue we hope to examine this re-composition of the Chinese working class in more detail.